The Pattern and Finance of Foreign Trade

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With special reference to the City of London

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PREFACE

THE second international banking summer school inaugurated and organised by the Institute of Bankers took place in Christ Church, Oxford, from the 3rd to the 16th September 1949. Some one hundred and thirty bankers from more than thirty countries contrived to make the school as great a success as its predecessor and proved that it is easy for men of similar interests to associate for the common good. The curriculum took the form of lectures—gathered together in this book—and unpublished discussions, on the Pattern and Finance of Foreign Trade, with special reference to the City of London.

I am happy that these initial efforts have been made during my term of office as President of the Institute. I choose this opportunity of thanking all those from abroad who participated, and the associations and banks who sent them, for their welcome collaboration with men from the commercial banks and accepting houses of the United Kingdom. I believe that through the use of their two common languages—English and banking—they have contributed in no small degree to a better understanding of the basic problem of today, the furtherance of world trade.

Balfour of Burleigh

November 1949.

The Emerging Pattern of International Trade

By

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(Professor of Political Economy, University of Oxford)

I SHALL begin by formulating four general propositions, which in combination seem to me to constitute the essence of the international trade problem of our time.

First, the impact of two world wars, together perhaps with certain other tendencies, has caused a large disequilibrium in the international balance of payments which it is both essential and difficult to correct. Second, in order to correct this disequilibrium large re-adjustments must be made in the flow of international trade, and also in the domestic economies of many countries, including both their productive activities and their habits of consumption. Third, the task of effecting these readjustments cannot be left to the unaided operation of the automatic forces of a freely working price system. These forces are capable of effecting small adjustments comparatively smoothly; but when the work which they have to do is large, they are apt to prove slow, clumsy, wasteful and erratic; and it is necessary to supplement them by more direct measures, including physical controls and quantitative arrangements of various sorts, consciously directed to the objects that have to be attained. Fourth, it is essential, on the other hand, to secure that the forces of the price system are also working towards these ends, that they are helping to promote and not to obstruct the readjustments that are needed. The influence which these forces exert is pervasive and unceasing; and it is shallow and shortsighted to suppose that if we multiply controls and elaborate plans sufficiently it doesn't matter how wrong our prices are, or how wrong our arrangements in such

matters as the level of money incomes and purchasing power.

I have stated these propositions in very general terms. I propose now to consider them more closely. It may seem unnecessary to say much more about the first. Certainly, there is no longer any need to dilate on the magnitude or the difficulties of the balance of payments problem. But it may perhaps be well to insist that this is a problem which must be solved. In some quarters there seems to be growing up a disposition to give it up as a bad job, to argue that the contrast between the productive power of the United States and that of Europe is too great for Europe ever to be able to pay for American supplies, and to suggest that the United States should accordingly assume the obligation of providing those supplies indefinitely, without any prospect of being paid for them. This would certainly be a remarkable application of the precept 'noblesse oblige'; or perhaps we might describe it as a curious international application of Communist doctrine: From each country according to its ability; to each country according to its needs.

Such suggestions are not realistic nor helpful; indeed, to my mind it is not fitting or even decent for British or European commentators to make them. For the purpose of setting Europe on her feet again the American people have shown themselves ready to give aid with a generosity which is without parallel in the history of international relations. By so doing, they have fully met every moral claim which can fairly be said to arise from joint participation and unequal suffering in a common struggle. For the sake of averting chaos and confusion and the danger of the spread of Communist domination, they might perhaps be willing to do more; to do things at any rate calculated to ease Europe's difficulties. But the idea that the British people or other European peoples can expect to be subsidised by the American people as an indefinitely continuing arrangement is preposterous; and when such suggestions are mingled as they often are with censorious criticisms of the backwardness of the American economy by the standards of our welfare state, there is a cool impudence about them which can hardly predispose Americans to do more to help.

In one way or another, the balance of payments problem *must* be solved, and of course in one way or another it *can* be solved. The curious defeatist notion that mutually advantageous trade and balanced payments are impossible between countries or continents with comparatively low or comparatively stagnant productivity and those with high and rapidly expanding productivity finds no warrant either in history or in common sense. It is true—indeed it forms part of the theme of this paper—that the all-round growth of American productivity raises problems of adjustment, which help to render obsolete some of the trading methods and philosophies which served us well enough in the nineteenth century. But the idea that this high American productivity is fundamentally injurious to us in Britain or in Europe is quite untrue. If the United States had been unable to spare for our consumption the supplies which the *Marshall* Plan has made available to us, we should have been so much worse off. Nor should we be better off if the supplies which we now find it necessary to cut out of our import programmes for lack of dollars did not exist at all.

My second proposition relates to the variety of the adjustments that are needed for a solution of the problem. It is clear that Great Britain must maintain a radically different balance between her imports and her exports than that of the 1930's, a much larger export trade or a much small import trade, or probably a combination of the two. It is equally clear that there must be a large change in the opposite direction in the import-export balance of the United States; the Americans must either import more or export less or both. It is also gradually becoming clear that the trade of other countries must be profoundly affected by these adjustments. The Continent of Europe, for example, was accustomed before the war to pay for its imports from the North American Continent partly through the medium of an export surplus to the United Kingdom, the proceeds of which could be converted into dollars. The United Kingdom will be unable in future to play its former role in that process; and consequential re-adjustments are therefore necessary in the trade pattern of Continental countries, apart from any which changes in their own circumstances may require.

The need for these large changes in the flow of international trade entails the need for important changes in the internal economies of the countries concerned. If the American people must import more or export less, it follows that they must consume more goods at home, including both producers' goods and consumers' goods, that is to say, reckoning internal investment activity as part of consumption for this purpose. Their rate of home consumption in this sense must increase to the extent of the change in their import-export balance *plus* the growth of their production; otherwise supply will tend to exceed demand, leading to trade depression and a waste of productive power. Nor in practice is it enough that consumption and investment should expand in the aggregate to this extent. Awkward maladjustments may occur if the demand for particular commodities fails to keep pace with their supply: and of course the increased demand for consumers' goods that arises from an increase in real incomes does not affect all goods and services equally. It usually takes the form of a substantial increase in the demand for certain things, and a negligible increase in the demand for others.

A very rapid rate of technical progress such as prevails in the United States is therefore apt to be a source of instability; and if the American economy has to digest not only the normal increment of production but a further potential increase of supplies arising from larger imports or diminished exports, the strain is increased. Cuts in British imports of American agricultural commodities are especially likely to cause serious structural problems with far-reaching repercussions. These considerations have undoubtedly contributed to the readiness of the American people and Congress to make generous arrangements designed to ease a difficult transition. Such arrangements have real advantages from the American standpoint, as magnanimous policies often have, though it is foolish to infer that it would be in the interests of the American people to give away their goods permanently for nothing.

So much for the adjustments needed in the American economy. What of those needed in Great Britain? Here too the problem has a global aspect and a structural aspect. There is the question of the balance between our aggregate consump-

tion and our aggregate production; there is the question of the detailed manner in which those aggregates are made up. I shall consider the global problem first. It is clear that our need to eliminate a large deficit in our balance of external payments carries with it the corollary that we have to spend less on current consumption and home investment than would otherwise have been feasible. There is inevitably a certain difficulty in effecting this. The production that we have devoted in the last few years to increased exports has done nothing to increase the supply of goods and services available for consumption at home. But such production generates purchasing power as much as any other; the wages and incomes which the producers of export goods receive compete for the supplies in the home market. In other words, the process of correcting an adverse balance of payments exerts an inflationary influence.

This difficulty need not, however, be very formidable. In theory certainly, and as a rule in practice too, it can be overcome by taxation, directed to preventing an excess of aggregate net income. And if, as it would be natural to expect in a post-war period, public expenditure were falling, this would not mean an actual increase in taxation, but merely smaller reductions than could otherwise have been hoped for.

Unfortunately this is not what has happened. The fall in public expenditure from its wartime peak has given place prematurely to a new, large continuing increase. The attempt has been made, it is true, to match this by increased taxation; and if the influence of financial policy on aggregate demand could be measured by a simple subtraction sum, if it depended solely, that is to say, on whether public revenue exceeded expenditure or *vice versa,* British financial policy might well have proved sufficiently austere to have reversed the inflationary trend in our economy by now. In fact it has failed to do so. Inflation continues in Great Britain, though it has ceased nearly everywhere else, at any rate outside the sterling area. That is perhaps the most serious aspect of the British economic crisis.

This object lesson should not have been necessary to demonstrate the important truth that the inflationary effect of an undue increase in public expenditure cannot be cancelled out

by increasing taxation to a commensurate extent. Higher taxation may be very efficacious in checking an expansion of personal expenditure, if that is all that needs to be done. But it cannot be used with any appreciable success to reduce personal expenditure below the standards that have become habitual. If the attempt is made to push it to this point, its main impact will be on savings. Those who were previously saving a portion of their incomes will save less; some of those who were saving nothing will draw on their accumulated savings. The effects on aggregate consumption will be inconsiderable.

On the other hand, a high proportion of the increased public expenditure will represent a net addition to demand. The increased expenditure on defence, for example, represents partly the direct absorption of man-power, partly the production of armament. The rapidly mounting expenditure on the health service represents to an important extent the consumption of additional drugs, additional spectacles, additional dentures, the recruitment of additional doctors, nurses, dentists and administrative staffs, and the erection of additional buildings. All this is a direct and substantial charge on our limited productive resources; some of it even has a direct impact on our balance of payments, such as the importation of lenses for the spectacles.

In ways like these we have increased our consumption considerably in the past two or three years; and, of course, we have not been willing to reduce our ordinary consumption to make up. Therefore our total consumption has increased at a rate decidedly greater than the increment of available supplies, arising from increased production less additional exports. Hence the continuance of inflation. We have failed, in other words, to make the global internal adjustment which is the corollary of our necessary external adjustment; and the large expansion of public expenditure is mainly responsible for this failure.

It is of the utmost practical importance in Great Britain at the present time that we should appreciate this fact clearly and make haste to mend our ways. The present drift of tendency is dangerous in the extreme. We really cannot afford a continuance of inflation, now that sellers' markets have given place to

buyers' markets in the outside world. If British goods remain far dearer than those of competing countries, our export trade will decline steadily, and the deficit in our balance of payments will widen. It is an illusion to suppose that an easy way out of this difficulty can be found in lowering the exchange rates of sterling. True, this would make British goods costing a given sum in pounds cheaper in terms of foreign currencies. But it would also raise the sterling prices of imported goods; these form an important element in our cost of living; and in an inflationary condition, marked by an extreme excess of demand over supply in the labour market, the risk would be serious that this would lead to a vicious spiral of rising wages, rising prices and further exchange depreciation. It has become only too probable that devaluation will prove necessary. That makes it the more important to end our internal inflation soon; for it is vital to end it first.

By our internal inflation, let me emphasise, I mean to indicate not so much the upward movement of prices and wage rates that is actually taking place, as the excess of demand over supply which lies behind this movement, including the fundamental factor of a large excess of demand over supply for labour. So long as this excess remains uncorrected, attempts to keep down the price level by special expedients, such as controls and subsidies, or remitting purchase tax or lowering the profit margin allowed on utility goods, cannot succeed. These are palliatives, which may be useful, or may be harmful, but do not go to the root of the matter. This is to be found in the fact that our total consumption is too high, our consumption, that is to say, of consumers' goods and producers' goods together. It is higher than our current production warrants, consistently with making ends meet on international account. To eliminate this excess is imperative. That is the essential internal adjustment that we have got to make; and there is no way of dodging it.

Our failure to make this adjustment so far exposes us as a people to serious reproach; for this particular task should not have been very difficult. It is not as though we had to reduce our total consumption; we had only to avoid an undue increase. The change required in our import-export balance is

large relatively to the prewar volume of either imports or exports. It means a large re-adjustment, therefore, in the flow of international trade, which, in an environment of buyers' markets, raises difficulties and problems which I have not yet reached. But this change represents only a comparatively small fraction of our national income or our national production. Even for 1947, when our production was seriously reduced by the fuel crisis and other untoward events, the deficit in our overall balance of payments, huge though it was, worked out at only about 8 per cent of the national income. For 1948 it was estimated at about 3 per cent. This could have been fully covered by two or three years of increased production at its normal rate of growth, if consumption had not increased as well. The *Marshall* Plan gave us more time than this.

To effect what I have called the global internal adjustment required of us, we had only therefore to keep our total consumption from growing at more than a very slow rate for a few years. Surely this should not have been too much to expect of us. Certainly there has been no lack of talk about the need for belt-tightening and austerity. Nor have such appeals and exhortations fallen by any means on deaf ears. The British public as a whole have accepted fairly trustfully the need for severe limitations on imports, for monotonous diets, for swingeing tobacco duties and high purchase tax, for all manner of deprivations and restraints. The wealthy have submitted without undue protest to graduated taxation carried to the limits of feasibility upon incomes and to special imposts on capital as well. The trade union leaders have done their best to respond to the official appeals for a wages standstill, and the wage demands that are being made, incompatible though they are with the necessities of our national position, are not immoderate in the light of two facts—(1) the overwhelming strength of the trade union bargaining position and (2) the fact that some rise of wages is genuinely needed in some occupations to maintain established standards of consumption.

Consumption of the ordinary type has not in fact increased, certainly not at an excessive rate. Nor do I personally regard our rate of capital expenditure in the last few years as excessive, though it contains some extravagant items and though the

total, of course, becomes more than we can afford, if we insist on spending so much in other ways. The main cause of our undoing, as I have already indicated, has been the phenomenal growth of public expenditure, especially on the Education Act and on the Health Service as well as on Defence. If we had had only one of these new costly schemes instead of both, or if circumstances had permitted a continued reduction of defence expenditure, we might perhaps have scraped through. As it is, public expenditure has grown at a rate which would have required us to reduce our ordinary consumption materially in order to live within our means. And that very naturally we have not done. We thus find ourselves entangled in a dense undergrowth of rising costs and labour maldistribution and dwindling savings, from which it will not now be at all easy to extricate ourselves.

We are beginning to pay the penalty for the modernist contempt for traditional principles of sound finance. To our superior minds even the maxim that the state must not absorb in increased expenditure in time of peace more than a reasonable proportion of the economic increment of the nation has seemed excessively straitlaced. Accordingly, we have now reached a point at which a stern application of the old-fashioned prescription of public retrenchment has become an indispensable condition of recovery.

I have dealt with this problem at a length which may seem excessive in a paper which is primarily concerned with international trade. But international trade problems cannot be judged in true perspective if the attempt is made to treat them in isolation from internal policies. For solving the international problem it is essential that countries should observe certain rules in their internal policies. And as the cardinal rules of good behaviour for the world of today, I suggest the following. On the one hand, countries with serious external deficits must avoid inflation even at the risk of unemployment. On the other hand, countries where currencies are persistently hard should strive to maintain a high level of effective demand, even if this means some risk of inflation. But even if these rules were observed, there would remain the structural problems to which I referred earlier. The change that we have had to try

and bring about in our import-export balance in Great Britain is, as I have said, a very large change relatively to our prewar volume of imports and exports. The calculation which received great publicity a few years ago that it is equivalent to about 75 per cent of our prewar exports is certainly not an overestimate. It is difficult to suppose that we can succeed, even after we have brought our selling prices down to a competitive level, in sustaining our export trade increased over the average of good and bad years to anything like this extent. It is almost certain that a considerable part of the change will have to be effected by keeping down our imports, as we have kept them in recent years, well below the prewar level; the present figure is about 85 per cent of the prewar volume.

If this is true, it follows that it will be necessary to maintain for an indefinite period a drastic system of import regulation such as we employ at present. It is foolish to suppose that on this matter we could afford to restore freedom of choice to the consumer, and rely on the higgling of the market in a free economy to stop our importing more than 85 per cent of our prewar imports. If free to choose, there is no reason to suppose that the consuming public, together with traders and manufacturers, would spend a smaller proportion of their incomes on imported goods than formerly. These incomes are at present sufficient to enable us to consume considerably more as a people than we did before the war; and though I believe, as I have already made sufficiently clear, that we are consuming more than our circumstances warrant, we are certainly not consuming anything like 15 per cent too much.

Our aim must clearly be to reduce the proportion of our expenditure which we devote to the purchase of imported goods, as we have in fact reduced it by our import controls. This cannot, of course, be done painlessly; but it can be done with far less hardship if the reduction is selective, falling heavily on some imports and sparing others, than if it is indiscriminate. If we are short of dollars it would be foolish to allow part of our limited supply of dollars to be used to purchase luxuries or goods that could be produced at home almost equally well, at the expense of having to curtail further our purchases of essential commodities that cannot be obtained

outside the dollar area. In such circumstances, moreover, it would be equally indefensible to allow individuals to spend unlimited dollars on holidays or travel; and it would be far too hazardous a gamble to allow investors or speculators to spend dollars on buying Wall Street securities in the hope that they might make capital gains. These considerations point straight to the need for quantitative import control, for exchange control, and for restrictions on foreign travel; and these needs will continue so long as the dollar problem remains difficult, which is likely to be a very long time indeed. The same necessities present themselves in other countries with balance of payment deficits.

This is not all. Our aim must be not only to reduce or keep down our expenditure on imports, but also to reduce the proportion of our imports which is drawn from hard currency sources. Various other countries find themselves under a similar necessity. A radical change in the channels along which international trade flows, a change in the geographical distribution of imports and exports, is indeed essential to equilibrium in the international balance of payments. This consideration points to the need for what is called discrimination, for the differential treatment in import regulation of imports from different countries, and for preferential tariff rates. This need also will last for the duration of the dollar problem. Nothing really could be more muddle-headed than to concede that the shortage of dollars makes it necessary to restrict imports for the time being, but to try to insist that these restrictions must be non-discriminatory. From the standpoint of sterling, trade between one sterling country and another is *internal* trade and the dollar shortage is no more a good reason for restricting such trade than it would be for restricting the movement of goods within the United Kingdom or within any other country.

For these reasons I have always regarded the idea of seeking to outlaw import restrictions and discriminatory trade practices, which represented the guiding idea of the long-drawn negotiations leading to the Havana Charter, as extraordinarily perverse. Both this Charter and the non-discriminatory undertaking of the Anglo-American Loan Agreement must, as it

seems to me, be allowed to remain a dead letter, or else will prove a serious obstacle to the re-adjustments that must be made. It is fantastically unrealistic to suppose that these adjustments will come about of their own accord, if only appropriate price levels, national income levels, and exchange rates are established and maintained in different countries. I do not question, on the contrary I emphasise, the necessity of securing appropriate price levels, national income levels, and exchange rates. As conditions of securing the needed re-adjustments they are indispensable. As the sole agents and instruments for effecting them, they are far too chancy and erratic.

We cannot dispense in these matters with the aid of deliberate policy, using whatever measures are likely to achieve this purpose most effectively. Among the measures which are likely to prove useful, there is one to which I have not yet referred, namely, bilateral trade agreements between pairs of countries, providing for the purchase of specified quantities of each other's goods and including sometimes long-term purchase agreements for primary commodities. The case for such arrangements is stronger in my opinion than is commonly appreciated. It springs from two facts: (1) the need to enlarge the non-American sources of supply of many agricultural commodities, and (2) the special risks which attach to the production of agricultural commodities for export markets. The period of time which is required to effect an increase of agricultural output is often very long. It is very different of course for different agricultural products, being especially long for tree products such as coconuts and rubber, but it is usually considerable; and a correspondingly long interval elapses between the time when a decision is made to increase production and the time when additional supplies are actually forthcoming. If in the meantime the prices of the products in question fall heavily, the producers may incur serious losses; and the experience of the inter-war period shows that those losses may be very serious indeed. Farmers, before deciding to produce more of some commodity which is in short supply, have to consider the prices that they are likely to be able to obtain when their products come forward to the market,

perhaps in a year or two, perhaps several years later.

This is why farmers in Great Britain, in the United States, in Australia, and elsewhere ask for something in the nature of 'guaranteed prices'; and speaking broadly, and leaving details aside, there is nothing unreasonable in this demand. After all, a manufacturer, as a rule, produces in response to definite orders at prices that are specified. It is not unnatural that agriculturists should also wish to know what prices they will get for their products before they produce them.

It has become part of the current international economic philosophy that something must be done to ensure agriculturists against a recurrence of such catastrophically low prices as marked the 1930's for many commodities produced for export. The remedy which is usually recommended is that of international commodity regulation schemes, which attempt to maintain reasonable prices by restricting production in each country within internationally agreed limits. It is of course very difficult in practice to evolve acceptable schemes of this type; many practical difficulties stand in the way. But the most serious and fundamental defect of this technique is that it ignores altogether the existence of the balance of payments problem. Indeed, it is apt to stereotype and accentuate disequilibrium. The usual practice in commodity regulation schemes is to allocate quotas to different countries in accordance with their respective exports in the past; and this would clearly make it more difficult to reduce the dependence of Europe on supplies from the American continent.

To reduce this dependence is one of the basic re-adjustments that has got to be made. For this purpose it is essential to develop alternative sources of supply; and long-term contracts or similar arrangements by which farmers in the Dominions or elsewhere are given some assurance as to the prices they will get seem to me a fundamentally appropriate means of doing so. It is true that the United States Administration has made it clear that it objects to such arrangements on the ground that they are inherently discriminatory, and in view of the political strength of American agricultural exporting industries, the objection to this particular species of discrimination is likely to persist. On this issue, however, it is the American position

which seems to me fundamentally unreasonable, natural though no doubt it is. We shall always be ready and eager to buy from the United States to the full extent of the dollar income we can earn either directly or indirectly by exports to other markets. It is neither good policy nor good sense to try to force us to buy more.

For these reasons I think it probable that long-term contracts and bilateral trade agreements will have an important part to play in the trading arrangements of our generation. They raise, of course, many practical difficulties and some dangers. The more circumstances require us to have recourse to such expedients the more important it becomes to observe the condition that price levels, national income levels, and exchange rates should be appropriate. If the prices of British goods are reasonably comparable with those of American goods, arrangements or restrictions which require overseas purchasers in the sterling area or elsewhere to buy British goods rather than American goods, in return for reciprocal security in the British market, may work smoothly to the mutual advantage of the countries concerned, and without any real injury to anyone else, having regard to the need for balance of payments equilibrium. If, however, the attempt is made to base such arrangements on the principle of indifference to vast price disparities, they are likely to give rise to increasing discontent and friction.

We should do wisely in Great Britain to pay heed in due time to the very natural resentment which is now growing on this point in various parts of the colonial empire. Malaya and West Africa are what are called net dollar earners. Much of their rubber and their cocoa is sold in the American market for dollars which are handed over to the Bank of England for sterling. In return they are expected to meet their import requirements by buying British goods at prices far higher than those at which similar goods could be obtained from the United States. Clearly these arrangements are not to their advantage. For the first time since the American War of Independence we are fairly open to the charge of exploiting some at least of the colonies for our own advantage. This is one of the most serious of the unintended consequences of our

national attempt to live beyond our means; and it constitutes an obvious threat to the cohesion of that peculiar institution—the sterling area.

This leads to another question of great importance which is closely linked with those on which I have already touched. The pound sterling still remains an important international medium of exchange; and most countries in the British Commonwealth continue to hold their monetary reserves in the form of sterling balances. These circumstances are on the whole of great advantage to us in Great Britain. They free a large part of our overseas trade from monetary complications and from the risk of extreme vicissitudes; and today, when sterling is inconvertible, they serve, like a system of mutual tariff preferences, to favour trade between the constituent parts of the sterling area. But these advantages are not and cannot be unmixed; nor can they be one-sided. The sterling area can only survive if it is felt by the other parties to it to be advantageous on the whole to them as well.

This implies two things in particular. First countries holding sterling balances must feel assured that they will be able to draw upon them to a reasonable extent in case of need. After all, these sterling balances play the same role in their economy that our gold reserve does in ours. There are, of course, limits to the 'unrequited exports', as they are called, that we can afford to make to sterling area countries at the present time; and the object of the agreements that are being made about the use of sterling balances is to define these limits. But some critics argue as though it would be right and reasonable for us to block these balances altogether; to forbid their holders to draw on them at all, even for the purpose of financing imports from Great Britain. We, it seems, in Great Britain may run down our gold reserve to meet *our* deficits; but no other sterling area country may do anything of the kind. This would be to treat the sterling area as an arrangement designed exclusively for the advantage of the United Kingdom. If we were to act in this spirit, the area would speedily disintegrate.

It would be equally fatal to attempt to use the arrangements of the sterling area as a means of securing especially favourable terms of trade for the United Kingdom. In our dealings

with our partners in the area, we must give fair value for what we get. This is another reason why it is so important that our prices should be reasonably competitive.

Price considerations cannot indeed be disregarded for very long without disastrous consequences. The system of import controls, inconvertible currencies and bilateral trade agreements, on which circumstances compel us to rely increasingly, makes it possible to pay insufficient regard to them for longer than is wise; and this may no doubt be regarded as a serious defect of the system. None the less, it is a profound mistake to suppose that this system could be given up, and that we might revert within a short space of time to the free conditions of the past. The manifest failure of our present policy makes it natural perhaps that many should be disposed to say: 'Let us try what a free economy would do. It might work better. It could hardly work worse.' But that is not true. Many things would be worse, including a runaway inflation which would be the most probable sequel to a removal of controls in an atmosphere of budgetary extravagance. Countries with serious balance of payments difficulties can afford neither financial profligacy nor economic *laisser-faire*. In the external sector of our economy it is essential to combine controls and direction with appropriate price relations. This is perhaps the most difficult and the most important of the tasks which challenge economic statesmanship.

The I.T.O. Charter

Proposed Rules for International Trade

By

MARCUS FLEMING

INTRODUCTION

SINCE the war there has sprung up a crop of new inter-governmental organisations, each concerned with one or other aspect of international economic co-operation. Some of these are of a temporary character. Of those which are, in intention at least, permanent I might mention the United Nations itself, with its Economic and Social Council, and various Regional Commissions, the Food and Agriculture Organisation, the International Monetary Fund and the International Bank for Reconstruction and Development.

The International Trade Organisation, which may conceivably become the most important of all the new permanent agencies, is also the last to be brought into existence. Indeed, it does not exist even now, for its governing instrument, the Havana Charter, though drawn up last year, still awaits ratification.

THE MAKING OF THE CHARTER

The Charter has been long in the making. This is perhaps not surprising in a document which purports to lay down a set of obligations and principles governing the conduct of member nations over an enormous sphere of international economic relations. For the I.T.O. will deal not merely, as its name implies, with international trade, but also with a number of other, at first sight, extraneous questions such as employment policy, the promotion of economic development, the regulation of restrictive business practices, and the making of international agreements on particular commodities.

Like most of the other international organisations which I have mentioned, the I.T.O. stems from point three of the

Atlantic Charter of February 1942, in which President Roosevelt and Mr. Churchill announced that the U.S.A. and the U.K. would endeavour

> 'with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity'.

These general principles were elaborated in the Mutual Aid Agreement of February 1942 between the U.S.A. and the United Kingdom—the Agreement which inaugurated the war-time Lend-Lease arrangements. Article 7 of this Agreement laid down that the benefits to be provided by the United Kingdom to the United States in return for the aid received should include

> 'provision for agreed action by the United States of America and the United Kingdom, open to participation by all other countries of like mind, directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples; to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers'.

Similar provisions were included in the Mutual Aid Agreements between the United States and other recipients of aid.

The next phase in the preparation of the Charter culminated in the appearance, in December 1945, of the U.S. Government's *Proposals relating to Commercial Policy.* This document, which resulted from discussions between representatives of the U.K. and the U.S.A. held in Washington in the autumn of that year, was accompanied by a general expression of approval in principle by the U.K. Government.

There followed a long, intensive and somewhat complicated process of international discussion in the course of which the *Proposals* were elaborated, amended and developed into the Charter as we know it today.

First came the appointment, by the Economic and Social Council of the United Nations, of a Committee of eighteen countries to prepare the agenda for a Trade and Employment Conference. This Preparatory Committee, as it was called, met in London in the autumn of 1946 and again in Geneva in the spring and summer of 1947. Working on the basis of a text provided by the U.S.A., the Committee elaborated a draft Charter for presentation to the United Nations Conference. Finally, at Havana, in the winter of 1947-8, a full-scale United Nations Conference was held and a definitive text established.

Various points are worth noting about this lengthy process of gestation from which the Charter emerged in all its glory and prolixity:

(*a*) First is the fact that the initial impetus, and to a lesser extent the driving power throughout the entire process, came from the United States of America. This in itself is something of a portent. Traditionally the U.S.A. has been regarded as a stronghold of high protectionism and an obstacle to the adoption of agreed rules of commercial behaviour. Even before the war, however, Cordell Hull's series of reciprocal agreements for the reduction of trade barriers marked a change of attitude. Since the war, as everyone knows, the U.S. has not merely poured out financial assistance on an unprecedented scale to build up those countries whose economies had been shattered by the war, but has also taken the lead in promoting a number of international agencies, two at least of which, the International Monetary Fund and the International Trade Organisation, make substantial inroads into national sovereignty in economic matters.

There is, of course, another side to the picture. The Americans have naturally tended to visualise the rules of international economic behaviour in the brave new world which they sought to create in a manner sympathetic to their own preconceptions—which favour free markets, private enterprise, and the freeing of international transactions from cumbersome restrictions. However, as the Charter has gradually developed it has come more and more to bear the impress of the needs and ideas of countries other than the U.S.A.

(*b*) The second point to notice is that the Charter was

originally formulated in a very narrow circle, consisting in fact of only two states, the U.S.A. and the U.K., and was then successively remoulded and revised to meet the criticism of larger and larger groups of countries. I feel sure that this is the only way in which such a long and complicated agreement could have been elaborated so as to meet as many points of view as possible without falling into internal inconsistency and contradiction. It might be objected that such a method gives undue weight to the views of those countries which participate in the early stages. I do not think, however, that an examination of the Charter would bear out this contention. Indeed, it might be nearer the truth to say that the countries associated with the draft Charter in its early stages tended to become so much identified with the project as a whole that they were willing, in order to secure its acceptance by other states, to make concessions which they would have been unwilling to make had the entire elaboration of the Charter been entrusted from the start to a world conference.

(*c*) Finally, I would like to draw attention to the amount of effort and brainwork that went into the preparation of this Charter. I doubt if governments have ever before made available so much administrative manpower and so many experts, for so long a time, in order to create a new international instrument. If the Charter turns out not to fit the needs of the modern world, the fault lies either with the political and economic circumstances of our time, or with the whole method of approach by way of multilateral agreement, and not with any lack of effort or attention on the part of the governments which participated in its preparation.

CHARACTER OF THE CHARTER

So much by way of description of how the Charter came to be. Let us now consider the document itself. It is a substantial affair of no less than one hundred and six articles and sixteen annexes, covering ninety-six pages of print in all. If the gestation period was prolonged the baby was proportionately large.

Not only is the document long, but it is complicated. Moreover, the prose in which it is written is not of the most limpid. Take the following sample, chosen at random:

'The Organisation may, if it deems such action necessary in exceptional circumstances, make representations to any Member entitled to take action under the provisions of sub-paragraph (*c*) that conditions are favourable for the termination of any particular deviation from the provisions of Article 22, or for the general abandonment of deviations, under the provisions of that sub-paragraph. After 1st March, 1952, the Organisation may make such representations in exceptional circumstances, to any Member entitled to take action under Annex K.'

You see what it is that we have to deal with. It is a legal document, a document which lays down general rules of behaviour, permits deviations from these rules in certain prescribed circumstances, lays down a procedure for ascertaining whether the rules are being observed, and provides for the punishment of infractions. It attempts to combine precision in the definition of rules with flexibility in making allowances for a large variety of possible contingencies. In this respect it differs markedly from the kind of documents on commercial policy which used to emerge from the activities of the League of Nations Economic Committee and from the various economic conferences in the inter-war period. At that time it was customary to draft binding international conventions only on matters of relatively restricted scope, such as the simplification of customs formalities, international commercial arbitration, or the like. On the broader aspects of commercial relations the prewar practice was to issue recommendations, couched in rather vague and general language as to the policies which nations ought, in the general interest, to pursue. Such recommendations had no binding force on governments.

The Havana Charter, on the other hand, places definite and important restrictions on the freedom of action of signatory governments. The complication of the document, the careful drafting of its 102 Articles, are a sign that governments realising that they are binding themselves, take the matter very seriously.

COMMERCIAL POLICY

Let us now examine the content of the Charter, beginning

with its most important section, dealing with commercial policy, which stretches roughly from Article 13 to Article 45. Now, commercial policy is concerned with the international exchange of goods—with imports and exports. The question might well be asked why bother to have an international agreement on the subject of exchange which seems, on the face of it, an essentially voluntary act. Why not allow each country to trade as it sees fit? The answer in the broadest terms is simply this: that the welfare of each country—its standard of living, its level of employment—is vitally affected by the willingness of other countries to import from it and to export to it. A second, perhaps more searching, question is this: Admitting that each country's trade policy affects each of its trading partners, why not allow commercial relations to be determined by bilateral agreements between pairs of countries? Such bilateral agreements have been a common feature of commercial relations for centuries. Even under the Charter, as we shall see, they retain a very important role. Why seek to get beyond them by making a multilateral agreement—always difficult to enforce and to adapt to changing circumstances? To this objection three answers may be offered:

In the first place, trade is often triangular in character. A sells more to B than B to A. Similarly B sells more to C than C to B. The triangle is closed by C selling more to A than A to C. Or there may be even wider circuits of trade involving more than three countries. Thanks to this set-up, B can make more valuable trade concessions to A than A to B, and similarly with the other pairs. If trade expansion depended on mutual concessions between pairs of countries, it might be unnecessarily limited in scope. Group concessions, on the other hand, might, in theory at least, be carried much farther.

A second, perhaps more important, reason for multilateral agreements is this. If two, or a limited number of countries, get together to make an agreement they may find the most profitable thing they can do is to exploit the outside world. This they can do, for example, by restricting their joint demand for imports from the outside world, thus forcing down the price, or by restricting joint supplies of types of exports (particularly primary commodities) to the outside world, thus

forcing up the price. This sort of thing, which tends to impoverish the world as a whole, can only be prevented by general multilateral agreements prohibiting or controlling commodity restriction schemes and prohibiting or controlling import policies which discriminate against third countries.

But the most important factor of all, those making for multilateral agreements, in my opinion is the desire to 'outlaw' certain practices, such as trade discrimination or quantitative controls over imports—the desire to banish them from the face of the earth, or at least to subject them to general rules and regulations. This desire is not perhaps entirely explicable on grounds of national interest, but springs from a more 'idealogical' motive—the desire to live in a certain kind of world.

Let us now examine the provisions of the Charter as they relate to particular forms of government control over international trade.

Tariffs

The imposition of taxes on imports and—much more rarely—on exports was by far the most important method of regulating trade applied before the first world war. Between the two world wars other forms of trade restriction, such as import licensing, made their appearance, and at certain times of stress replaced tariffs as the effective barrier to imports in the case of many countries. Today, on most frontiers, tariffs are of secondary importance. There are, however, certain very important exceptions to this generalisation. Tariffs are still the limiting factor on imports in the case of the 'hard currency' countries, U.S.A., Canada, Switzerland and Belgium, and also within the Sterling Area, where quantitative restrictions are the exception.

The traditional method of bringing about a reduction in import duties, or of providing safeguards against their increase, is for two countries to get together to make a commercial agreement containing mutual concessions on those commodities in which one or the other is primarily interested. After the World Economic Conference of 1927 attempts were made by the Economic Committee of the League of Nations to get countries to agree to multilateral or collective agreements

which would either set maximum limits to the duties imposable by any country on each category of merchandise, or else would provide for a uniform percentage reduction on existing duties.

These attempts came to nothing, but in the earliest stages of the discussions which ultimately led to the Havana Charter the twenty-year-old ideas of the maximum tariff limit and the uniform percentage reduction of tariff rates, and various possible combinations of the two, were resuscitated and considered afresh. But a percentage reduction would have penalised low tariff countries, and, in particular, countries where tariffs being fixed in money terms had been reduced by the rise in prices since before the war. And a uniform maximum tariff, besides being rather hard on the countries who start by having a relatively high tariff, takes too little account of the circumstances affecting particular commodities. To have a different maximum tariff for each commodity, again, would have opened up an endless field for discussion and dispute which might have made agreement impossible.

So the solution adopted in the Charter as regards both import and export duties is to leave them to be determined by the old-fashioned method of bilateral negotiation.

The only precise obligations with respect to tariffs assumed collectively by members of I.T.O. under the Charter are those relating to margins of preference. A margin of preference is the amount by which the tax levied on imports from one country falls short of the tax levied on imports from another country. In general the Charter says there are to be no such preferences. Each member is to give most-favoured-nation treatment to each other member. But exceptions are provided to cover margins of preference already in force within certain groups of countries of which the most important is the British Commonwealth. Even in these exceptional cases margins of preference must not be increased.

In asserting the most-favoured-nation principle with the exceptions which I have noted, the Charter is reaffirming one of the most ancient but also one of the most debatable of all the maxims of commercial policy. On the one hand, most-favoured-nation treatment, or non-discrimination, is certainly

the principle which would prevail in an ideal world. Any departure from it is either a cause or a symptom of a distortion of trade. But where countries are free to distort or impede trade in other ways it is not clear that matters will be improved by insistence on non-discrimination. Admittedly most-favoured-nation treatment has the advantage that any trade concession made by one country to another is automatically extended to third countries. On the other hand, the knowledge that any concessions which the two parties may make to each other will be extended to countries which have offered no immediate *quid pro quo* is a deterrent to making these concessions. Still further disadvantages of the non-discrimination rule will be considered later when I deal with quantitative import restrictions. Considerations such as these began to carry great weight in the years just before the war when, for example, various groups of countries, such as the Oslo group, sought, in vain, exemption from the M.F.N. rule for the purpose of reducing trade barriers between themselves.

Apart from these provisions on M.F.N. treatment and preference margins, the only general obligation imposed by the Charter with regard to tariffs is an undertaking to carry out, on the request of any other member, negotiations directed towards the substantial reduction of the general levels of tariffs and towards the elimination of those historic preferences of which I have spoken. Though the word 'elimination' is used in connection with these preference margins, it is not the intention that they have to be eliminated at one fell swoop, but only that, in the long run, their elimination is envisaged as a result of a series of 'mutually advantageous' negotiations.

Tariff negotiations have already taken place as between the countries participating in the Preparatory Committee and certain additional countries, and the resulting agreements have been incorporated in the General Agreement on Tariffs and Trade. These negotiations were carried out simultaneously between pairs of countries during the Geneva meeting of the Preparatory Committee. In advance one would have said that it was beyond the skill of man to cook up anything useful in such a witches' cauldron of negotiation. Nevertheless, the task was accomplished and the concessions appearing in the

General Agreement are not only regarded as satisfying the requirements of the Charter but they are in a sense made the basis of all future negotiations. Any member of I.T.O. which wishes to enjoy the full benefits of the Charter, including the tariff concessions incorporated in the General Agreement, must become a party to that Agreement, which means it must make sufficient concessions on its side to induce the existing parties to admit it.

This process still continues. Only this summer the present Contracting Parties, twenty-three in number, have negotiated tariff concessions with ten other countries. If as a result the newcomers accede to the General Agreement, the Contracting Parties will number no less than thirty-three states. Add to this that the General Agreement contains, in addition to the aforementioned tariff concessions, most of the other Charter provisions relating to commercial policy, and it will be seen that an important part of the Charter is already in operation, on a provisional basis at least, between a group of states which account for an overwhelming proportion of international trade. These negotiations have led to substantial concessions on tariffs and preferences. The cynic might say that this was only made possible because tariffs are in so many cases no longer the effective barrier to imports. This cynicism, however, would be misplaced at least in the case of the United States, where quantitative restrictions on imports are few. The reductions already effected in the U.S. tariffs have been significant—no small achievement in a dollar-hungry world.

Quantitative Restrictions

The next type of foreign trade control we have to consider is known as 'quantitative restriction'. This covers prohibitions, quotas and individual licensing whether applied to imports or to exports.

Quantitative restrictions have generally been regarded as more harmful and uneconomic than tariffs, and between the two wars attempts were made to stamp out the practice altogether. In part, no doubt, this was because quotas and prohibitions were new and unfamiliar inventions of the devil, introduced during and immediately after the first world war,

whereas tariffs were evils which familiarity had robbed of their terrors. But there were also more concrete reasons for the peculiar aversion they inspired. They caused the trader more trouble and uncertainty than tariffs. They were rigid and inflexible and, by their means, the normal effect of cheapness in winning access to foreign markets or even in winning ground from rival exporters could be frustrated. They were liable to be altered by administrative decision according to the needs of the moment, instead of being, like tariffs, fixed by legislative decision or subject to long-term commercial agreements. Finally, they were frequently used to effect a degree of protection and trade discrimination which governments would scarcely have dared to bring about by the more open method of import duties.

During the period between the end of the first world war and the Great Depression, the dismantling of quotas and exchange restrictions was carried out in most countries with remarkable speed. In the 'thirties, however, the tide turned. The Great Depression and the cessation of American lending put many countries into balance of payments difficulties, and a high proportion of them, particularly in Central Europe and Latin America preferred exchange restrictions and import quotas as a method of defending their reserves to the alternatives of higher tariffs or devaluation. As compared with tariffs, quantitative restriction enabled countries to adjust their imports more exactly to the available supply of foreign exchange. As compared with devaluation, it enabled them to avoid both deterioration in the terms of trade and the risk of internal inflationary repercussions. It also conferred a power of controlling and 'steering' imports which was useful both for bargaining with other countries and for strategical and political purposes. Quotas were introduced by certain countries, e.g., U.K., as a means of stabilising the domestic market for agricultural produce. A number of rather half-hearted attempts were made, in the recommendations of international bodies during the 'thirties, to narrow the scope and mitigate the severity of import and exchange restrictions, but with little success.

The Charter treats trade restrictions very differently from tariffs. Whereas tariffs, provided they are non-discriminatory,

are left to be determined by bilateral negotiation, quantitative restrictions are, in principle, prohibited except where they are used for certain permitted purposes. And the extent to which they can be used for these permitted purposes is to be determined in the light of certain more or less precise criteria either by the country applying the restrictions or by the International Trade Organisation itself.

The main purposes for which a country may use import restrictions are:

firstly, to safeguard its balance of payments, that is, to protect its foreign exchange reserve;

secondly, to restrict the supply (and hence to raise the price) of agricultural products on its home market;

thirdly, to implement an inter-governmental commodity agreement, and

fourthly, to promote its own economic development and reconstruction.

Time does not permit me to examine more than one of these types of restriction, viz., that designed to protect the balance of payments.

A country whose monetary reserves are running short, due to an adverse balance of current payments, has only three ways of obtaining speedy relief—to restrict the general level of demand for goods and services at the risk of causing substantial unemployment, to borrow from abroad, and to limit imports. Since, according to postwar ideas, it is wrong to compel the country to adopt either of the first two courses of action, it must be allowed to follow the third. Moreover, it must be allowed to carry out this limitation of imports by quotas and licensing rather than by tariffs, as only by the former means can expenditure on imports be precisely adjusted to the foreign exchange resources available.

The Charter not only permits quantitative restrictions in such circumstances but leaves it in the first instance to the country concerned to be the judge whether the payments difficulties are such as to warrant the application of restrictions.

The Organisation can, however, call upon the members to consult with it regarding its restrictions, and the possible alternatives thereto. Moreover, it is open to any other member to complain that the restricting country is applying the restrictions unnecessarily, or in a manner unnecessarily damaging to the interests of other countries, or that in its domestic policies it is paying insufficient regard to the need for restoring its balance of payments 'on a sound and lasting basis'. The Organisation, if it finds the complaint justified, and if the offender will not mend his ways, can permit the plaintiff, and indeed all other members, to carry out certain measures of retaliation.

It is arguable that these provisions are open to the possibility of abuse in that a country might deliberately maintain itself in balance of payments difficulties (e.g., by maintaining an overvalued currency) for the sake of being allowed to control or restrict trade. The only safeguards against this contingency which the Charter has to offer are, *first*, the obligation on members 'in carrying out their domestic policies, to pay due regard to the need for restoring equilibrium in their balance of payments as a sound and lasting basis', and, *second*, the obligation to participate in discussions initiated by the Organisation to remedy any general disequilibrium causing a persistent and widespread application of import restrictions.

The general rule of non-discrimination applies under the Charter to quantitative restrictions no less than to tariffs.

Where, however, quantitative restrictions on imports are imposed to safeguard the balance of payments, important and far-reaching departures from the rule are permitted.

I suggested earlier that a wooden adherence to non-discrimination might lead to a raising of unnecessary barriers to trade. This is supremely true of import restrictions which are required to conserve foreign exchange. A country may have too much of one foreign currency and too little of another, and yet be unable to convert the former into the latter. In such a case it would be absurd if all the restrictions which it was obliged to apply to imports paid for in the scarce currency had to be extended to similar imports paid for in the plentiful currency. The justification of discrimination in this case was recognised in the earliest U.S. *Proposals*.

But even apart from the inconvertibility of currencies, there is a strong case for allowing discrimination whenever a widespread scarcity develops in one or more important world currencies. Suppose that two countries are both short of dollars and try to balance their accounts by restricting imports, not only from America but from each other. The restrictions which they impose on their mutual trade do nothing to improve their *combined* position in respect of dollars and, therefore, do nothing to reduce the degree to which, taken together, they have to restrict direct dollar imports—they are just unnecessary and pointless restrictions on trade.

The earliest drafts of the Charter had permitted discrimination against currencies which had been declared to be scarce by the International Monetary Fund. Unfortunately the Fund is so constituted and administered that a currency may have been desperately scarce in the foreign exchanges of the world for many years before the Fund has run short of it or officially declared it to be 'scarce'.

In the final version of the Charter, after a good deal of discussion and debate, an extremely complicated set of provisions was devised which give, or can be interpreted to give, a fairly wide latitude in the matter of discrimination, at least so far as the period up to 1952 is concerned—the so-called postwar transitional period. For most countries the kind of trade discrimination which they are allowed to exercise will depend on the kind of exchange restrictions which they are allowed to have under the International Monetary Fund Agreement. Certain countries have elected to have a separate regime relatively independent of the Fund.

How far discrimination can be carried on after March 1952 is extremely obscure. It depends largely on the attitude which will be taken up by the International Monetary Fund on the one hand and the International Trade Organisation on the other. In principle the right to discriminate is supposed to be a temporary and exceptional arrangement for the transitional period only. In practice it is difficult to be sure that the conditions justifying discrimination will not recur from time to time in the further future.

State Trading

We come now to one of the most novel parts of a Charter that is full of novelties. Most of the trade rules we have been considering consist of limiting the interference of governments with private trade. Free trade would be the ultimate ideal towards which such rules tend—of course without ever reaching it. But what is the Charter to do about public enterprise, which nowadays plays a much more important part than before the war, both in international trade and in domestic industry and trade?

Of course, the principle of non-discrimination has to apply to public enterprise as well as to state interference with private enterprise. But how does one define non-discrimination in this case? Does it mean that a state enterprise should always buy in the cheapest market and sell in the dearest? This would be to tie it down more severely than any private enterprise. What about long-term contracts and customer relationships? The solution found in the Charter is to say that state enterprises must buy and sell 'solely in accordance with commercial considerations' and that they must afford to enterprises in other countries opportunities to compete for participation in such purchases and sales. This is fairly straightforward, though it has to be borne in mind that 'commercial considerations' may mean something very different to a state import board with enormous bargaining strength than to a private industrial trader under competitive conditions.

A more ticklish problem is how to set a limit on protectionistic restriction of imports by means of state enterprises. Here a distinction is made in the Charter between state enterprises which do and those which do not possess a monopoly with respect to the import or export of any product. The behaviour of the trade monopolies is treated on the same lines as tariffs, namely, it is made the subject of bilateral negotiations. As far as export monopolies are concerned the nature of the arrangements to be negotiated is left rather vague. But import monopolies have to establish a notional import duty or margin by which the domestic selling price may exceed the landed cost or import price, and it is laid down that where practicable it is

this import duty or margin which is to be the subject of bilateral negotiation. Moreover, the import monopoly has to satisfy the full domestic demand for imports at the domestic selling price which results from adding the notional import duty to the import price. This principle that state traders are expected to behave in accordance with price criteria rather than quantitative criteria opens up a very interesting line of thought.

Where state enterprises are concerned which do not possess such an export or import monopoly it is assumed to be unnecessary to make similar arrangements. Such enterprises are merely subject to the general National Treatment article which lays down that internal taxes and laws, regulations and requirements affecting the internal purchase and sale of products should not be applied so as to afford protection to domestic production against imports.

DEVELOPMENT

A special section of the Charter, Chapter III, is devoted to the subject of Economic Development and Reconstruction. This Chapter, though it is laid out separately from the Commercial Policy Chapter, is really primarily concerned with creating an important set of exceptions to the provisions of the Commercial Policy Chapter.

It has, of course, long been recognised that even from this standpoint of the world as a whole there is a strong economic argument for giving temporary assistance, if necessary by protection against foreign competition, to branches of industry which are in an early stage of development. The argument can be extended to cover the case of an industry which, though long established, is in process of turning over to a new technique, or to the reconstruction of an industry destroyed by war. In addition to this, a somewhat more dubious argument of a semi-social nature is often advanced in favour of protecting new industries, the establishment of which is desired for the purpose of diversifying the occupational structure of a country, particularly a new country of the primary producing 'colonial' type.

Before the War, commercial policy proposals took little

account of the needs of development, as such, and the original U.S. draft of the Charter contained no special provisions to promote development. This state of affairs was, however, completely altered as a result of a persistent campaign by the underdeveloped countries in the Preparatory Committee and at the Trade Conference itself. Successive drafts of the Charter gave greater and greater privileges to the underdeveloped countries.

The Charter provisions with regard to development fall into two parts. There is a 'positive' part, rather woolly and repetitive, in which members undertake to develop their own territories and to assist the development of other countries. Creditor countries agree not to withhold funds, equipment and technology unreasonably. Debtor countries agree not to take any unreasonable action against foreign capital and to give reasonable opportunities for new investments—of the kind they welcome. Both types of countries undertake, if requested, to negotiate agreements designed to facilitate investment by providing security for foreign capital. The I.T.O. assumes certain responsibilities with regard to the provision of technical advice and assistance to member countries.

More important, however, are those provisions which modify the strict application of the trade rules in the interest of development and reconstruction. This modification of the trade rules does not amount to much in the case of products where the would-be developer has undertaken some obligation in the negotiation with other countries, e.g., the obligation to bind or reduce an import duty. But where there has been no such obligation the I.T.O. is allowed to waive the rules forbidding, say, import quotas, or export subsidies, and is even obliged to do so in certain cases; for example, it would be obliged to allow a country to protect an infant industry by means of a quota if such quota is likely to be less restrictive of international trade than any other measure permitted by the Charter, such as a tariff or a direct subsidy on output. This, of course, is a very substantial concession, but it may be a justifiable one. In the case of an infant industry the risk is very great and the market security afforded by a quota may be more effective in inducing timorous private enterprise to invest in plant and equipment

than the more uncertain protection afforded by a tariff.

But the most remarkable concession of all which has been made to the underdeveloped countries is that they are allowed in certain circumstances to make new preferential agreements in the interests of the economic development of one or more of them. The Organisation is not merely allowed to authorise such agreements, but is obliged to do so if the applicants form part of a single economic region and if certain other conditions are fulfilled, such as that the preference is necessary to create a wide enough market. Only if the agreement is likely to jeopardise the economic position of some outside member can the Organisation withhold its consent. This provision is liable to cause a good deal of trouble in times to come. If the term 'economic region' were interpreted narrowly so as to require geographical propinquity a signal injustice would have been done to long-established preferential areas, like the British Commonwealth which, apart from this Article, are not allowed to establish new preferences.

By and large, it must be agreed that very generous treatment has been meted out to the underdeveloped countries. A great deal, of course, depends on the discretionary authority vested in the Trade Organisation.

EMPLOYMENT AND ECONOMIC STABILITY

We come now to a part of the Charter which, at first sight, one is surprised to find there—so little does it seem to have to do with international trade. I refer to Chapter II, on Employment and Economic Stability. Surely the maintenance of employment is largely a question of domestic finance rather than international trade? It must be confessed that the existence of employment provisions in the trade charter is something of an historical accident and that had the agitation in favour of international undertakings on employment policy gathered sufficient strength earlier, it might have found expression in the Monetary Fund Agreement or even in a separate Convention on Employment. As it is, an undertaking to promote full employment both by national action and by international co-operation finds a place in another international instrument, the Charter of the United Nations.

Nevertheless, there is considerable justification for having employment provisions in the Trade Charter. Free trade and full employment are, to some extent, competing aims of policy. A country which is finding difficulty in maintaining full employment may be strongly tempted to exclude competition from foreign imports, thus, in the current phrase, 'exporting unemployment' to other countries. Moreover, even if it tries to provide the employment by expanding or maintaining domestic demand for goods and services, it may find that this policy involves it in balance of payments difficulties which necessitate the imposition of import restrictions, particularly if other countries on their side are failing to maintain an equally high level of employment and demand for goods and services.

The worst situation of all from the point of view of the observance of trade rules is one in which some countries are pursuing an effective full employment policy and others are not. It is natural to conclude that if *all* countries could be induced, as a matter of international obligation, to pursue an effective full employment policy, the hazards involved in adhering to the trade rules of I.T.O. and the exchange rules of the I.M.F. would be, at any rate, reduced to tolerable proportions. From another point of view it is important that the plea of employment policy should not be used as an excuse for getting out of legitimate commercial policy obligations. For both these reasons employment provisions were brought within the ambit of the Havana Charter.

The main provisions are the following:

First, an undertaking on the part of each member to take action to maintain full employment and large and steadily growing demand within its own territory.

Second, a provision that, in exercising its discretionary functions (for example, in deciding whether a country was entitled to go on restricting imports or to go on discriminating against imports from hard currency countries), the I.T.O. should take account of members' need to protect themselves against deflationary pressure from abroad (for example, a slump in the United States).

Third, a provision that, if one member's currency is so hard to come by that other countries are forced either to allow unemployment for the purpose of reducing imports or else to restrict imports directly, both sides, and particularly the scarce currency country, will take action to put the situation right (for example, by the scarce currency country increasing its imports, or its foreign lending).

These provisions, taken together with those which allow countries in balance of payments difficulties to impose discriminatory import restrictions, do provide a fairly effective glasshouse where countries can protect the tender plant of full employment against the cold blasts of deflation coming from the outside world. The protection is not perfect, of course, for employment in the export trades is necessarily uncertain and there may be difficulties in paying for the raw materials without which full employment cannot be assured. But at any rate there should not be any need to curtail credit and demand in order to protect the exchange reserves.

COMMODITY AGREEMENTS

I have no time to refer in any detail to those sections of the Charter which deal with Inter-Governmental Commodity Agreements and with Restrictive Business Practices interesting as they no doubt are. Each could serve as the subject of a separate lecture. The justification for including them in the Trade Charter is different in the two cases.

Commodity agreements are included because such agreements cannot be effective unless the participating countries are free to apply measures, such as export and import quotas, which necessitate a special exemption from certain of the trade rules of the Charter. But if such exemptions are to be allowed for commodity agreements a procedure must be laid down to determine what is, and what is not, a legitimate agreement.

The main requisites of an approved commodity control agreement are the following:

It must, as a rule, relate to a primary commodity.

It must be considered after adequate preliminary study

of the problem that an agreement is necessary to prevent hardship to producers.

Consuming countries must have equal rights with producing countries in making and operating the agreement.

There must be provision for gradually increasing the share of output drawn from the most economical producers.

Prices must be fair and reasonable and must 'have regard to the desirability of securing long-term equilibrium between the forces of supply and demand'.

One might perhaps have wished that the provisions of the Charter had given more encouragement to methods of securing price stability which do not involve restriction — such, for example, as buffer stocks, or the method of multilateral price guarantee as applied in the Wheat Agreement. But given that restrictive Agreements are necessary, the Charter provisions represent an enormous advance on prewar conditions, when agreements were arrived at among producers without consumer representation and with scant regard for consumer interests.

RESTRICTIVE BUSINESS PRACTICES

Of Restrictive Business Practices I will say even less. The justification for dealing with them in the Charter is that they may sometimes—for example, in the case of market-sharing agreements—have the effect of restricting international trade, and may even act in a similar way to governmental measures, such as export controls, which are forbidden under the Charter. Broadly speaking, the effect of the Charter provisions on this subject is to bind Members to prevent private business practices affecting international trade which conflict with the objectives of the Charter, and to set up a procedure for investigating complaints that this obligation is not in some particular case being complied with. Recommendations for remedial action may be made to Members, but no enforcement action is contemplated.

Before concluding this description of the Havana Charter, I should say a few words about the nature of the International Trade Organisation of which it is the basic instrument.

THE ORGANISATION

The I.T.O. is to be a specialised agency of the United Nations open to all countries invited to the Trade Conference and such others as it may admit. Unlike the International Monetary Fund, where there is a system of weighted voting, decisions are taken on the basis of one country, one vote, an arrangement which perhaps carries with it som danger of lack of realism. This may be offset to some extent by the creation of an Executive Board of eighteen countries, of which eight must be the member countries of chief economic importance.

The Organisation is vested with very considerable discretionary authority. I think it is fair to say that, as the Preparatory Committee came under pressure to admit more and more derogations from the splendid simplicity (relatively speaking) of the rules set forth in the original draft—exceptions to meet the horrible complications of real life—the dilemma how to make the rules sufficiently flexible without destroying their effect altogether was often resolved by giving discretion to the new Organisation. This is particularly true with regard to exceptions in favour of development, and to the provisions allowing discrimination in certain circumstances (though here the discretion is sub-allocated for the most part to the International Monetary Fund). The Commodity Policy Chapter, too, leaves a good deal of scope to the Organisation. In addition to all such particular provisions, Article 77 gives the Organisation the right by a two-thirds majority to waive the rules in exceptional circumstances not otherwise provided for. It is clear that, if the Charter ever comes into force, the Organisation will have plenty of work to keep it in trim.

CONCLUSION

I have now reviewed the contents in a manner which, while tediously complicated, does not begin to do justice to the complexity of the document itself. Can anything be said in concluding about the adequacy of the system of trade rules and principles set forth in the Charter to the needs of the modern world?

In the first place, I should remind you of what I said at the beginning: that the Charter has not yet been ratified by governments and, quite possibly, may never formally enter into force. Yet I feel fairly sure that, even if the letter is stillborn, the spirit will survive and will find other means of expression. We have seen that the commercial policy provisions are already applied on a provisional basis by the Contracting Parties of the General Agreement on Tariffs and Trade. The Commodity Policy provisions too are already being applied, though in broad principle only, as a result of a resolution passed by the Economic and Social Council.

The Havana Charter is open to attack from two angles. On the one hand, contemplating the tangled skein of exceptions and qualifications attached to almost every rule, one is tempted to conclude that the Charter, like a Gruyère cheese, consists chiefly of holes. If the eminent Dr. Schacht had been summoned before the bar of I.T.O. to answer for his economic misdemeanours in the prewar period, there are few for which he could not devise a colourable defence by appealing to one or other of the clauses of the Charter.

On the other hand, it could be maintained that the Charter, despite being so heavily punctured by exceptions, still retains too many traces of the liberal dogmatism of its origins to correspond to the realities of the modern world. This applies particularly to the provisions relating to discrimination. In a world in which full employment is the first Article of the Faith, balance of payments difficulties, occurring somewhere or other in the world and affecting a substantial part of world trade, are likely to be a much more constant feature of the economic landscape than even in the inter-war period. The best endeavours of the I.M.F. in the matter of exchange rates, credit, and the like are unlikely to avoid a situation in which the currencies of the world will differ from each other in respect of 'hardness' and 'softness', though the order of precedence in respect of 'hardness' will not always remain the same. In such circumstances it is self-defeating to interpret the principle of non-discrimination in a way which really implies that all currencies are equal and that no country is involuntarily restricting imports for balance of payments reasons.

The answer to both these objections is perhaps the same. The Organisation, not the Charter, is the thing. The interpretation of the Charter in many cases lies with the Organisation, and the interpretation will have to be guided by the spirit of the Charter rather than by the letter. The Directors of the I.M.F. have shown the way by agreeing to many things which would have shocked the draftsmen of Bretton Woods. Nor need the interpretation be all in the sense of relaxation. Case law may lead simultaneously to a raising of standards and to their more flexible formulation. For this the chief necessity is that there should be a centre where governments can get together to discuss their trade affairs, strike their bargains, and justify their policies in the light of accepted principle.

International Trade Agreements

By

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YOU will have realised from the subjects which you have been discussing that this Summer School has been taking place at a most critical time for the whole system and the whole future of international trade and finance. It has covered the period of the financial and economic discussions in Washington between the United States, Canada and the United Kingdom. The outcome of these talks not only affects the financial and economic position of this country, they have been concerned with what must be regarded as the central problem of the whole system of world trade and finance, namely, the relations between the dollar areas and the sterling area. It would clearly be unrealistic for me to discuss the question of international trade agreements and of the trading relations between the United Kingdom and the other nations of the world without some word about the economic background, particularly in relation to the problems which have given rise to the discussions in Washington.

Anyone who has studied the trend of international balance of payments over the past few months will realise that the present difficulties confronting the United Kingdom are not a problem of the United Kingdom alone, nor indeed of the whole sterling area. But they are acute for the sterling area, and so much of the problem centres on the sterling area for two reasons. In the first place the recent trend of international payments, while in no sense confined to, much less caused by the United Kingdom, bears particularly heavily on the United Kingdom because we are far more dependent on overseas trade—not only for finding markets, but more particularly for meeting our essential requirements of food and raw

materials—than any other nation. Just as in the nineteenth century Britain gained perhaps more than any other country through the expansion of world trade, so in the twentieth century Britain has perhaps suffered more than most other countries through fluctuations and difficulties arising in world trade. In the post-war world these difficulties affect not so much the market for our exports as the central problem of our ability to obtain our essential imports. But, secondly, the sterling area in particular is acutely affected by recent trends in international trade because the sterling area, itself the largest area of trade based on a single currency, with 600 million inhabitants and over a quarter of the total trade of the world tends to reflect and in many ways to centralise upon itself the world's dollar problem. For a short time, indeed in 1947, when this country almost alone in the non-dollar world introduced a system of convertibility of its currency, we were bearing not only our own dollar deficit and to some extent that of Canada and other countries, but with the rush of other countries to earn dollars through the conversion of sterling we were bearing the brunt of the dollar problem of practically the whole of the world.

But in a wider sense the discussions which have just taken place in Washington are not to be regarded as an attempt to deal with short-term or recent developments. As the Chancellor pointed out to the House a few weeks ago the problems which have been discussed at Washington represent a fundamental unbalance in world trade and world payments dating back for more than a generation.

Before 1914 we had a fully multilateral system based on convertibility of currencies and resting largely on sterling. With a rapidly developing division of labour in the world, the total of trade would have been greatly restricted if trade between any pair of countries had been limited to the amount which would have produced an exact balance between them. Between any two countries, a most serious disequilibrium could arise and be maintained, while the system as a whole was in steady equilibrium. What one country could buy of a given commodity from another depended on its being able to sell some produce (perhaps not directly related to it) in a third country,

which in turn could only buy because it could sell something else in a fourth—and so on through perhaps ten or a dozen apparently unrelated transactions untimately completing the circuit by which the monetary settlements balanced out. Each individual trading transaction was, by its nature, bilateral, but the monetary settlement of the transaction was only possible and was only kept in balance by the unconscious and unplanned working of a highly complex pattern of international trade and payments. Nor did the balance of the system depend only on the international transactions which entered into it. One country's demand for the products of another depended largely on its domestic use and consumption of those products, while its ability to pay for them depended on its ability to find users and consumers in other countries of quite different goods which it could export. Between these exported goods and the goods imported there might be little or no obvious or direct connection.

The old gold standard system was not in any sense as it has too often been regarded, a purely automatic and smoothly working arrangement. Professor Sayers' *Bank of England Operations Before 1914* and many of Professor Hawtrey's works are sufficient proof of that. Much less did it represent a static system of world payments, for during the half-century before 1914 we not only saw a phenomenal expansion in the total volume of trade, but within the general expansion fundamental changes were taking place, including, for instance, the establishment of Germany and in a different sense the United States as great industrial powers, without disrupting the working of the system. With all its faults, with all the degrees of control which had to be exercised, with its social consequences and problems, which I could not hope to deal with today, that financial system worked.

The war of 1914-18 brought with it shocks to the old system of world trade and payments far more fundamental and far reaching than were realised at the time or for many years after the end of the war. The destruction of the most important central European power, the dislocation of the world system of payments, the growth of secondary industries in many neutral, and some belligerent countries, who were

unable to obtain their supplies from their old accustomed sources, political and other factors paralysing the movement of capital, the dislocation of exchange rates, internal monetary instability and outright inflation in parts of Europe; all these factors dealt a blow to the old system, which mere nostalgia and a desire to get back to normalcy were not sufficient to counteract. The return by this country to the gold standard in 1925 at what has been generally agreed since was the wrong parity, was aimed at re-establishing the essential position of sterling in world markets. But in spite of chronic deflation, which produced unemployment and industrial troubles at home, the position of sterling, even so, could not be held. The dislocation of world trade, the growth of tariffs in the late 1920's and the early 1930's, particularly in the United States, the loss of confidence in Europe, the collapse in industrial activity and primary prices over the greater part of the world, led to the Great Depression. Every nation sought its salvation in self-regarding economic measures, each country aiming at improving the position for itself by means which exported its unemployment, only to find it re-exported by similar measures taken in other countries, measures which the International Trade Charter now seeks to outlaw.

It was in this context, and against a background of sinister political developments in Europe, themselves affecting the system and method of overseas trading, that this country first embarked on a policy of bilateral trade agreements. I refer to these not so much because they provide in any way a precedent or model for the international trade arrangements of the last two years but more because I shall want, in a few moments, to point out the fundamental difference between the two types of agreements and because there have been many criticisms both in this country and abroad that our policies in the past two years have been in fact a reversion to pre-war bilateralism. Indeed even the word "Schactian" has been used in this connection.

There was throughout the inter-war period a fundamental unbalance in trading between the dollar areas and the rest of the world, an unbalance partly righted and partly masked, in the 'twenties by a tremendous volume of overseas lending

from the new world to the old, and in the 'thirties by large movements of gold from the sterling area and from Europe to the United States. It has been calculated that between 1919 and 1939 $12,000 million worth of gold flowed into the United States and a total volume of $7,000 million worth of overseas investment flowed from the United States. For our part at least in the immediate pre-war years, aided as we were by terms of trade—the ratio of our import prices to our export prices—more favourable than we had known for a century past and certainly more favourable than we have known since, there was no serious balance of payments crisis. While figures produced during and since the war have shown that we were in deficit in 1938, for example, to the tune of £70,000,000, the favourable terms of trade and the return on our investments prevented that from being a major economic problem. As a seriously over-deflated country with mass unemployment, particularly in the old export areas, our problem was far less one of balancing our overseas accounts than of finding new markets for the products of British industry and thus means of making inroads into our figure of unemployment. Our dollar problem, too, even though we shouldered the dollar deficit of the whole of the non-dollar world, was not an unmanageable one in the late 1930's. Although in those years we were paying for not much more than a quarter of our total dollar imports with our exports to the dollar areas, invisible earnings, and more particularly the earnings of the rest of the sterling area, including those attributable to gold movements, were sufficient to bridge the gap. We had an enormous deficit with the United States and Canada on direct account. Canada had a substantial deficit with the United States. Europe, in general, had a deficit with the United States. But the dollar earnings arising from shipments of tin, rubber, cocoa, gold, wool, jute, sisal, and so on from the sterling area were sufficient not only to cover our own deficit with the United States but to enable us to meet our own deficit with Canada in United States dollars. This in its turn enabled Canada to cover her own deficit; and in addition to this we were able to cover the greater part of the dollar deficit of Europe. In the multilateral system which was still operating,

our huge export surplus with the rest of the sterling area made this quadrilateral, or even, if Europe is taken into account, quinquilateral flow of dollars possible.

So the bilateral arrangements which we concluded with, for instance, Scandinavian countries, were in no sense a serious breach in the multilateral system. Still less were they based on any attempt to ensure supplies of vital raw materials and foodstuffs, since these were all in conditions of chronic world surplus. What they were aimed at was securing guaranteed markets for certain of our exports. In general they took the form of providing markets for British coal at a time when coal was in surplus supply and putting limits to tariff and quota arrangements which might otherwise have reduced the scope for reviving trade after the 1931 crisis. The fact that coal and other commodities named in these agreements have entered into post-war so-called bilateral arrangements is not a proof that we are still following the same policy of pre-war days. Indeed the emphasis on these commodities itself draws attention to the fundamental difference between pre-war and post-war trading deals. In post-war agreements these commodities are the concern of the importing country in order to secure minimum guaranteed supplies, in pre-war days they were the concern of the exporting country, in order to secure a minimum guaranteed market.

I do not, I know, need to stress the yet greater shocks which were inflicted both on the United Kingdom sterling area and on the whole system of world trade by World War II. The destruction and slow post-war recovery of great supplying areas, the physical damage to transport as well as to production facilities, the loss of overseas investments, the greater dependence of the non-dollar world on the undamaged dollar areas for essential supplies, the change in the terms of trade, the loss of shipping income, and the special difficulties associated with the relative prices of sterling area exports—rubber, gold, etc.—in relation to sterling area imports, these things are too well known to require any repetition.

Faced with the fact that we had to increase our exports to a figure measured in terms of volume very much greater than pre-war in order to preserve even a minimum standard of

living, our efforts in the first two years after the end of the war were, with the help of the American and Canadian lines of credit, directed to building up our exports as quickly as possible and to doing everything in our power to aid the recovery of those countries, whether in Europe or in Asia, which normally provide us with an important proportion of our import needs. Payments agreements had to be made with many countries, trade with whom had been cut off by the war, and we had to get the wheels of trade turning once again. But in order to survey the progress of our trade arrangements with particular countries it is, I think, necessary to pass on quickly to the autumn of 1947.

As I do not need to remind you we were faced in that period with a critical situation. The slow recovery of our normal supplying areas, the yet further worsening of the terms of trade against us, coupled with the failure of the European harvest, the rapid depletion of the American line of credit due to these factors, as well as to the run on sterling during the convertibility period and the high rate of Government dollar expenditure abroad, had brought our dollar position to a critical state. With virtually no dollars apart from those we could earn and with an export drive which, though increasing month by month, was still radically inadequate to pay for our import needs, we had to make very special efforts to maintain a minimum volume of imports. In this situation there were three things we had to do.

First, we had to build up our trade relations with every country in the world from whom we could obtain necessary supplies. In particular, in order to get trade moving once again we had to persuade many countries who were themselves short of their own products to put a proportion of their goods into the export market, so that in return they could count on getting the goods they needed from us, of which we ourselves were short.

Secondly, we had to restore confidence in sterling as an acceptable currency, since the suspension of convertibility had undoubtedly, at least for the time being, dealt it a grave blow. Many countries who had sought avidly to earn sterling when it was the sure means of getting dollars were less keen to sell

to us after convertibility had been suspended. And in building up once again the acceptability of sterling over as wide an area as possible, we rightly felt that we were taking the only immediate step available to us towards the ultimate multilateral world trading system which was then, as now, our objective.

Thirdly, we realised more than ever how necessary it was to contribute both to the recovery of war-shattered European economies and to the development of overseas territories within the Commonwealth.

In the months immediately preceding the convertibility of sterling, payments arrangements or monetary agreements had been concluded with a very large number of countries. Indeed it was a necessary consequence of the Washington Loan Agreement that such arrangements should be made. Following the suspension of convertibility new arrangements had to be made with each country to deal with the new situation. In addition, trading arrangements which had already been the subject of informal understandings, and in one or two cases full bilateral discussions, naturally came up for review. Countries who had been satisfied to take convertible sterling, which meant world-wide purchasing power, now became insistent on obtaining from the sterling area the essential supplies they could have purchased elsewhere with the currencies obtainable for convertible sterling.

So it was that in the autumn and winter of 1947-8 formal agreement or informal understandings were reached with some thirty countries. They varied widely in character from the formal trade and payments agreements with the Argentine or the Soviet Union to the understandings reached with a number of other countries, or in some cases the mere examination of the likely course of trade and payments between the two countries (such as ourselves and Canada) in the new situation. With most countries formal payments agreements had to be made, particularly in those cases where arrangements were made for the transferability of sterling to third countries. In some cases these formed part of the general trade discussions; in others they were entirely separate.

There have been few aspects of our post-war trading policy

on which there has been so much misunderstanding as the trade agreements made with countries during this period. We have been misunderstood, for example, about the export of goods of potential military value. Our export policy, however, includes the control of goods of potential military value and such goods are not made available in the course of trade discussions if to do so would be against our security interests. But the most prevailing and, perhaps the most dangerous, misunderstanding has been the suggestion that with these countries we entered on a system of barter arrangements, or that in some way we arranged to pay for, e.g. timber with shipments of steel, or bacon with shipments of coal. In fact, not only was there no barter, but there was no system of direct exchange of commodities. In every case it was provided that trade would take place through existing trade channels, whether public or private against payment in sterling. The idea that there was barter or exchange of commodities arose, no doubt, because there were understandings or undertakings about the supply of scarce commodities, in both directions, in some of the agreements, and also because in every case the arrangements envisaged a rough equivalence of payments in the two directions (allowing for invisibles and, where appropriate, third country transfers) at the highest possible level of trade and exchange. But the scarce commodities entering into the agreements were in no sense bartered one against the other. It would certainly not have been in our interest, as an advanced industrial trading nation, to have restricted trade between ourselves and any other country to a mere exchange of essential scarce commodities. We have always exported manufactured goods, including many which in an austerity age would hardly qualify as essentials, in return for a much higher proportion of food and raw materials which by any standard would be regarded as essential. Had we entered on trade discussions in 1947-8 determined to barter those scarce commodities which we were in a position to export, we should have been condemning our trade, our imports, and our standard of living and employment to an all time low level. There was a further complication with many countries, including Scandinavia, Eastern Europe and many South American

countries. Goods even of an essential character which we were in a position to export and which the other country wanted, would by the very nature of the process of production (not to mention the congested state of order books), take a long period, possibly two or three or more years to deliver, whereas the goods we were importing were from current production and required urgently. It was therefore essential that some importers should plan on the basis of holding the sterling earned from current exports of food and raw materials in order to pay at a later date for capital goods ordered in 1947 or 1948, but not likely to be delivered until later years.

But inevitably certain scarce commodities did enter into the pattern of trade, though in only very rare cases was there a Governmental undertaking on our part to deliver them. In 1947 not only coal and steel but certain textile intermediate products (such as wool tops, cotton yarn and rayon staple fibre) many chemical products, especially alkalis, were urgently needed, particularly by European countries in order to restore industrial production. We ourselves were all too short of these items, but we were willing to export them both to aid European recovery, and in order to secure much needed goods for ourselves. I expressed the view on more than one occasion in Canada, where there has been quite considerable misunderstanding of our so-called bilateral agreements, that if it had not been for some of these arrangements, the recovery of Europe might have been held back for a generation. Just as the scarce goods we were in certain circumstances willing to export were urgently needed at home, so it was equally true that other countries could spare the goods we needed only by considerable austerity and sacrifices in their own home consumption. As I said in Ottawa 'There were countries in Western Europe starving for want of coal and steel and other materials who, though themselves perfectly capable of consuming all their own supplies of timber for physical reconstruction—and foodstuffs for home consumption—were willing to ration those commodities at home and to export them, but only on condition that in return they could count on our sending them the minimum supplies of coal and steel and engineering products necessary to keep their economy alive.

We, for our part, short of coal as we were in 1947, chronically short of steel, were willing to export these materials only if we could know that by so doing we could ensure the supplies of timber and foodstuffs which we needed even more. The alternative to bilateral arrangements in those days would have been a Britain living on an impossibly low standard of food consumption, with the housing programme completely held up for lack of timber (since we were already buying all the timber then available in Canada and the United States). It would have meant on the other hand, European countries consuming their own products, but with their economies brought to a standstill through lack of coal and steel.'

But the scarce commodities which enter into the pattern of our export trade were never sufficient to pay for more than a small proportion of our imports from any particular country. A typical arrangement with, shall we say, Ruritania, might have provided for a build-up of trade to a total of approximately £20 million in each direction. United Kingdom imports under such an arrangement might be made up of something like £20 million worth of timber or wood pulp or foodstuffs, with perhaps a few less essential commodities admitted in order to keep the normal channels of trade alive and to prevent undue hardship to producers in the country with whom we were dealing. On the side of our exports it might have provided for £1 million worth of steel, £1 million worth of coal, £1 million of scarce textile materials (wool tops, cotton yarn, etc.), £1 million worth of scarce chemicals, £1 million of capital equipment (probably ordered in earlier years) and an undertaking on the part of Ruritania to allow import licences for perhaps £7 million for our traditional lines of manufactured goods from the United Kingdom. The remainder, £8 million, in this illustration would represent sterling accruing to Ruritania which would either be spent on essential sterling area raw materials (rubber, wool, etc.) or perhaps in part held in reserve to pay for engineering equipment ordered at that time and due for delivery at a later date. The illustration I have given is obviously an over-simplified one. In most cases provision would have to be made for the expected balance of invisible earnings, in many cases for third

country transfers of sterling, in some cases for war debt repayments, for payments on account of compensation for British property nationalised in the country concerned, and in one or two extreme cases for the sale of British capital assets, e.g. the Argentine railways. But the principle is the same, to try and strike a rough balance in payments at the highest possible level, to promote the principle of movement of essential goods, particularly raw materials, and so far as possible to open markets to the flow of less essential goods. But this "rough equivalent" did not mean that we were attempting to confine trade to a bilateral pattern between the United Kingdom and the countries with whom we were negotiating. For the arrangements covered payments not only to the United Kingdom but with the rest of the sterling area, then as now, as I have said, the largest multilateral trading area in the world, and the provision for third country transfers of sterling with many countries showed the efforts we were making to get away from a purely bilateral balance.

Within this pattern, as I have said, about thirty special trade arrangements were made. The arrangements with Scandinavia (Finland, Sweden and, to a small extent, Norway) covered a high proportion of our need of timber and wood pulp. The arrangements with Western Europe covered principally foodstuffs and signalised the beginning once again of our coal export trade to Europe. The Trade Agreement with the U.S.S.R. of December 1947 provided for a substantial movement of coarse grains to this country. Against this we agreed to facilitate the placing of orders, with the firms concerned, on a purely commercial basis, for scheduled items of engineering equipment, amounting to about £20 millions worth in all. The only delivery commitment on our part was to supply 25,000 tons of rails (mainly Government surpluses), worth less than 1 per cent of the total value of Soviet deliveries to us. In the event orders placed in 1948 for items of engineering equipment on the schedule amounted to about £4 million, and for other engineering supplies not on the schedule to about £15 million, mainly for delivery in subsequent years. A very high proportion indeed of the whole of the sterling earned from the sale of the grain and other exports—indeed a good

deal more, including certain third country transfers, and some withdrawals from sterling balances—were spent on sterling area raw materials, mainly wool and rubber.

The Andes agreement with the Argentine provided for the supply of meat, hides and feedingstuffs, while arrangements with Brazil, Poland, Hungary, France and many other countries provided for a wide range of essential imports of food and raw materials and a much needed breach in the system of import restrictions against British goods which would not have been possible without these special arrangements. But I cannot too strongly emphasise that none of these agreements partook of the nature of barter. Those who have said that our dollar export drive, e.g. to Canada, has been frustrated by bilateral agreements have not understood the nature of the trade agreements we have made. It has been suggested, for instance, that we have bartered steel against timber and that if that steel, urgently needed in Canada, had been sent West instead of East, we could have got all the timber we required from Canada in return. But, as I have pointed out on a number of occasions in Canada, the total volume of steel sent to Northern and Eastern Europe—much of it war surplus of types for which no demand existed in the dollar areas—amounted in value to only a very small proportion of the timber, wood pulp, etc., which we brought from Europe, and without which we could not have carried on. That timber, wood pulp and so on, which we bought, was paid for not in steel but in sterling—sterling earned through the sale of a wide range of miscellaneous export products. Had we diverted the whole of our steel to Canada not only would that have paralysed the recovery of our neighbours in Western and Northern Europe, but it would have enabled us on a barter basis with Canada to have paid for additional timber from that country equivalent to perhaps only one-tenth or one-fifteenth of the timber and other essential raw materials we obtained from Europe.

I have said that the trade agreements and other arrangements were based almost wholly on sterling, except those with Western Germany and Japan. Dollar transactions did not enter into them, but in one or two cases such as Switzer-

land, Belgium and Portugal provision was made that if payments got out of balance one way or the other by more than a stated figure, settlement should be made in gold. In fact, with both Switzerland and Belgium (the latter including, of course, the whole Belgian monetary area) payments have gone against us and reached the gold point—I am using this phrase in its new and specialised post-war sense and not its traditional one—and substantial losses of gold have occurred. In consequence in our negotiations with those countries we have had to take the most stringent precautions to cut our imports, particularly of less essential goods, not to mention our tourist expenditure, down to a minimum, and in our export drive great emphasis has been laid on the need to expand export to those areas since, as I need not remind bankers, gold is worth its weight in dollars even today.

The trade arrangements to which I have referred in the year or so from the autumn of 1947, together with generous aid from the United States and Canada and yet closer economic relationships with our sister nations of the Commonwealth, ensured our minimum supplies and played a great part in that increase of industrial production, which was a necessary condition of any improvement in our general economic position.

I have referred to the Commonwealth countries. In general, apart from special arrangements with countries who held substantial sterling balances arising out of the war and where it was necessary to arrange a controlled release of sterling (and in certain cases quotas for dollar expenditure) there has been no need for special bilateral arrangements. The generosity of our friends in the Commonwealth revealing itself in gifts and loans, which we have so much appreciated, together with the willingness of countries in the sterling area to hold sterling against the time when the prices of their primary products might have fallen from immediate post-war levels, enabled us to maintain trade on a reasonable and expanding basis with the Commonwealth and sterling area.

Most of the trade arrangements made in the autumn and winter of 1947-48 have come up for review and renewal during the past year. In general the procedure followed has

been the same as in the previous year but there have been one or two changes in the economic setting in which they were made. In the first place the lack of desire to hold sterling was rapidly overcome, and by the winter of 1948-49 sterling had become a highly desirable currency, partly because of the increase in prices of certain sterling area products, particularly raw wool, but also because the world had come to realise that not only the United Kingdom, through her rapidly developing export drive, but the rest of the sterling area was in a position to deliver the goods. So to accept sterling was not merely to accept a currency, but to accept purchasing power over highly desirable goods from a very productive area.

Another change in the situation has been that many goods which were scarce two years ago are now in relatively free supply. Cotton yarn, wool tops, many of the previously scarce chemicals, even coal—apart from particular qualities—have become less scarce and can no longer be regarded as bargaining counters in international trade agreements. On the other side too, although foodstuffs are still, as I need not remind you, far from being in a position of easy supply, some of our main food imports have now been ensured on a relatively long-term basis by such arrangements for instance as we have made with Denmark where it was provided that 75 per cent (formerly 60 per cent) of Denmark's butter export surplus and 90 per cent of her bacon surplus would come to this country. At the same time paper, woodpulp, pulpwood and certain types of timber have become less scarce and in recent bilateral discussions price has been of much more importance than the guarantee of minimum supplies. Indeed, in some of these commodities we have not taken the full quantities that we have been pressed to take at the price we were being asked to pay.

A third factor which has become of increasing importance has been that of import restrictions. Many countries in Europe faced with serious currency difficulties, particularly in non-European currencies, have intensified import restrictions on a wide range of goods, and more and more in bilateral discussions we have pressed for the removal, or at least the relaxation, of these restrictions. So in recent agree-

ments and understandings the fixation of quotas for imports of particular commodities, on both sides, has played a greater part. In this connection the Intra-European Payments Scheme introduced a year ago in association with the European Recovery Programme has made it possible for certain Western European countries to maintain their trade at a higher level than would otherwise have been possible. Because of the very substantial volume of drawing rights which we, for instance, have made available, France, for example, has been able to take a larger quantity of sterling area products than she could otherwise have done. The importance of bilateral trade discussions in seeking to open markets against import restrictions has, therefore, something of a pre-war ring about it, though the setting and motives are still quite different.

I would not wish to detain you this afternoon by a recital of the trade agreements that have been reached in the past year but perhaps I could give an illustration of a not unrepresentative agreement by reference to two recent series of discussions taken at random, namely the recent agreement with Brazil a month ago and the discussions with Finland last January. In both cases I quote from the official Press release.

Brazil

"The two Governments undertake, subject to agreement on price and quality and bearing in mind the basic principle of reasonable equilibrium in current sterling payments in both directions, to do all that is possible to grant the necessary export and import licences for the goods listed in the trade schedules.

"The agreement relates to the year 1949, but will be automatically extended for a further three months unless either Government gives notice to the contrary by November 30, 1949.

"The schedules of trade between the United Kingdom and Brazil during 1949 provide for United Kingdom exports to the value of £30,775,000 and imports (including rice for other Commonwealth countries) of £33,349,500. In addition, supplies of petroleum and petroleum products

to Brazil are expected to be maintained at about £7½ million.

"The programme of exports from the United Kingdom to Brazil includes coal, iron and steel manufactures, non-ferrous metal manufactures, chemicals, machinery, vehicles, textiles, pottery and other consumer goods. The total estimated United Kingdom exports for 1949—£30,775,000—compare with exports of £26 million in 1948.

"The proposed imports from Brazil include raw cotton, hides, timber, coffee, cocoa, and some meat, sugar, tobacco, oranges, and Brazil nuts, together with rice for British Commonwealth territories.

"The text of the Exchange of Notes and the accompanying trade schedules will be published as a White Paper as soon as possible."

Finland

"The United Kingdom expects to import from Finland increased quantities of timber, pulp and newsprint. In addition Finland will continue to export to the United Kingdom other products of her woodworking industries at least to the level reached in 1948.

"The United Kingdom side have given indications as to the extent to which the United Kingdom can meet Finnish requirements of coal, oil, steel, wool, and other essential commodities in which the Finnish Delegation expressed particular interest. For the rest there will be included in the Finnish import programme a wide range of goods including textiles, chemicals, machinery products, and other manufactured goods of a kind which normally figure in the United Kingdom export trade to Finland.

"Trade between Finland and the United Kingdom in 1948 developed very satisfactorily, and showed a considerable increase on that of the previous year. These discussions encourage the hope that in 1949 there will be a further significant expansion in the trade between the two countries."

He would be a rash prophet who seeks, as I do not, to look to the future of international trade agreements. It must be clear today, if it has not been clear before that the whole future pattern of world trade depends upon the arrangements which can be made to redress the unbalance now existing in world trade as a preliminary to establishing the one world multilateral trading system which is the objective of us all. But while I would not in the least wish to try to forecast the future, I feel it would be right for me to conclude by saying this. Whatever steps may be taken to bring stability into our trade through long-term purchasing arrangements conducted in accordance with commercial principles—whether privately or publicly undertaken—bilateral trade agreements, as such, do not play any part in the kind of trading system to which we are looking forward. I have expressed my belief that if we had not embarked on this policy two years ago our own recovery and that of a large part of the world would have been set back for many years. Goods have entered into international trade which would never have done so; import restrictions have been relaxed which would never have been relaxed had it not been for these arrangements. But in the last year our trade arrangements have been considerably liberalised and as I have said more and more emphasis has been placed upon the opening up of markets. Even in the much misunderstood Argentine Agreement, they have been in error who have concluded that this has been an attempt on our part to ensure permanent markets to the exclusion of other suppliers for years to come. Certainly we have sought—and who in present circumstances would question our need to do so—to guarantee our meat supplies from the Argentine for a reasonable period ahead. But the indications we have made of probable supplies of goods from this country to the Argentine relate to a single year only and are in any case subject to agreement on commercial terms. In succeeding years, commercial considerations, particularly price, quality and delivery dates, will come even more into their own. We have not sought to erect a system of bilateral agreements cornering for ourselves an unfair proportion of trade to the exclusion of others. Where Ruritania has ex-

pressed her desire to buy from us rather than from other exporters that is not a result of the Anglo-Ruritanian trade agreement nor of any attempt on our part to use our buying power to blast open a market for our goods, it is simply a reflexion of Ruritania's shortage of particular scarce currencies. To remove that unbalance in world payments which leads to these problems must be the main objective of economic statesmanship in every country. Import restrictions, imposed for balance of payments reasons, we want to see removed. And as soon as may be we want to see import restrictions which are imposed for less respectable reasons, such as the protection of home industries, banned as an instrument of national economic policy.

The efforts which we and other countries in Western Europe through O.E.E.C. are taking to relax quantitative restrictions on trade in Europe may well be an important step towards this goal. If our efforts are successful the need for bilateral trade arrangements as a means of breaking down restrictions will be very much reduced. For, given the sort of world to which we look forward, and for which we are working, we do not seek to return to a system of bilateral trade agreements as a means of ensuring markets which cannot be won in fair competition and as a result of commercial considerations.

British International Payments Agreements

By

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THE very existence of a payments agreement is in itself an admission that something has gone wrong. It is a confession of failure of the breakdown of an automatic, harmonious, smooth mechanism of international payments such as the world enjoyed under the gold standard. A payments agreement, in this respect, may be likened to rationing and price control, which are interferences with the free price mechanism and admissions that this mechanism has broken down. As long as currencies are freely convertible there is no need for payments agreements. The task which such agreements perform does itself under conditions of multilateral convertibility.

But here let me interpose one very necessary reminder. The world has not invented payments agreements in order to make economic life more complicated than it need be. It is not out of love of bilateralism for its own sake that we have forsaken the smoothly functioning system of multilateral convertibility of currencies which the greater part of the civilised world enjoyed between, say, 1870 and 1914 and again between 1925 and 1931 and, with a few reservations, between 1931 and 1939. What we should never forget is that it was not the gold standard and the free convertibility of currencies which gave the world in those days its relative equilibrium, its balance of international payments. The sequence must be reversed. It was the balanced, relative integration of the main national economies plus the basic dominance of sterling—of which there was always an adequate supply in the world—which made the gold standard and free convertibility of currencies possible.

We must beware of reversing that sequence; of believing that it only needs the restoration of convertibility and all that goes with it to restore the world to that balanced equilibrium we all desire. That is putting the cart before the horse. We in Britain were induced, rather against our will, to do it in 1947—and with the consequences which will be familiar to you all. The punishment we then took may have had too great a psychological effect on our authorities; I sometimes think it has. But they are following a very sound instinct in working first for natural equilibrium—of prices and of balance of payments—and leaving the principles of convertibility and wholly multilateral trade to be added as the coping stones of the edifice they are trying to rebuild.

But when all that has been said—let us still bow with some reverence and also some nostalgia to the state of affairs which existed before we had to have payments agreements—and let us express the hope that those days may return, and with the blemishes which undoubtedly marred that old international order removed.

From our point of view the clear line of demarcation between the old order and the new—between the automaticity of a freely convertible currency and the inconvertibility which called for payments agreements—falls in 1939 with the establishment of exchange control. After we left the gold standard in 1931 sterling remained a freely convertible currency. Britain became a party to the tripartite agreement with the United States and France. But this was not a payments agreement. It was an agreement between these three governments—later joined by Belgium, the Netherlands, and Switzerland—to iron out seasonal and speculatively induced fluctuations in their exchange rates.

At the rates which evolved under the controlled free markets of that era there was true convertibility. There were no restrictions here on making payments to any part of the world. The need for payments agreements did not, therefore, arise.

The only approach to such agreements which was made by Britain during this period was the establishment of clearings with a small number of countries which themselves were in

serious financial difficulties and had suspended the convertibility of their currencies. The most notable example was the clearing agreement with Spain following the civil war. The main purpose of that agreement was to set up a single channel for the two-way payments with a view to retaining Spanish sterling out of which to repay British creditors of Spain. The clearing agreements of this period, to which Britain was a party, were to be regarded far more as debt-collecting arrangements than as payments agreements.

I should add that in many countries, and notably in Germany and Central Europe, where currencies were inconvertible and exchange control had got into its stride, the clearing and compensation agreements of the 1930s were genuine payments agreements of the type to which Britain was later to have to descend.

Before I begin to describe this descent into the inevitable bilateralism of payments agreements I must mention one very important fact which mitigates the drawbacks of any bilateral arrangements to which Britain is a party. It is this: when exchange control was begun in Britain it was decided, and quite rightly decided, that for purposes of control the sterling area, later to become known as the scheduled territories, should be treated as one single unit within which there should be the maximum freedom of movement of funds.

You will find, therefore, that in all the payments agreements made by Britain it is not Britain but the whole sterling area which stands on one side of the bilateral deal. This goes quite a way in mitigation of the restrictionist effect of any arrangements of this character. It means in effect that the non-sterling party to the agreement is, as a result of that agreement, able to trade and to conduct his payments not with one but with a large group of countries which constitute today the only widely scattered area within which there is in fact reasonably free multilateral trading and convertibility of currencies.

The descent into the bilateralism of payments agreements was an inevitable consequence of the setting up of exchange control at the beginning of the war in 1939. This was not immediately apparent, or even immediately realised. The period of the 'phoney' war in the military sense was accom-

panied by a comparable period of phoney war economics, during which the motto was, if not 'Business as usual', then 'Business with as little interference as possible from the need to finance and wage war'. This was very true of exchange control, and I well remember the assurances which came from the authorities at the Bank of England and the Treasury in those days that no control of exchanges should be allowed to undermine or injure the status of sterling as a great international currency. That was to be the supreme consideration, and I need hardly add that in those few months before we awakened to the realities of total war, exchange control was a somewhat inefficient instrument, and yet at the same time it was extremely rigid in that it treated the whole world of neutrals as belonging to one category, between which and sterling there was no automatic convertibility.

It soon became apparent that the sterling accounts of American nationals would have to be given specially favourable treatment. We were depending on the United States to provide us with the sinews of war, lend-lease was still a far-distant dream, and the commercial transactions between that country and the sterling area had to be established on a normal cash-on-delivery basis. There could be no question of blocking any sterling which accrued to American nationals as a result of exports to the sterling area. It was in June and July of 1940 that the decision was made to give the sterling accounts of United States and also of Swiss banks, and later of approved corporations in those countries, a special status of 'registered accounts'. It was stipulated that all payments between the sterling area and the United States had to be made either in dollars or through a registered sterling account. The sterling balances held in those accounts were convertible into dollars at the official selling rate in London.

The sterling accounts of other countries outside the sterling area became known as 'special accounts'. These special accounts were opened and operated as a result of bilateral agreements made between Great Britain and the non-sterling and non-dollar countries with which we were maintaining commercial and financial relations in that period. It was at this period, the summer of 1940, that the operation of sterling exchange

control plunged into bilateralism. The general rule was to allow the special accounts of any particular country to be used only for transactions between that country and the sterling area. Argentine special accounts, for example, canalised the trade between Argentina and the sterling area.

Since Britain was running a substantial and indeed inevitable current account deficit in that period, the trend was for sterling to accumulate gradually and in some cases quite substantially in many of these special accounts. It was in these accumulations that part of the abnormal building up of sterling balances on overseas account began to manifest itself. The need to provide convertibility of this sterling, which was paramount in the case of the United States, did not apply to those other countries. They were prepared or compelled by circumstances to hold sterling, and they did so. It should be added that in one or two cases where the countries concerned were either in control of important strategic materials or had particularly convincing advocates to plead their case they were able to obtain if not convertibility then at least exchange or gold guarantees in respect of their accumulations of sterling. Needless to say, little or nothing was publicly said about these arrangements. To have done so would have merely encouraged all the others to ask for similar privileges. It may, however, be said that Portugal, for example, obtained a gold guarantee for her accumulations of sterling on Portuguese special accounts and that comparable rights had also to be given to Persia and Argentina.

These arrangements of registered and special accounts provided the basis on which payments arrangements of the sterling area with the non-sterling world was built up and developed during the war. The strict bilateralism of the special account arrangements was softened at a comparatively early stage of this period by the introduction of a certain element of controlled or administrative transferability. Some special account countries were inclined to run short of sterling even at that period, while others had an abundance of this currency.

It seemed reasonable in those circumstances to allow the countries with a surplus of sterling to use it to pay another with a sterling deficit. It should be added that these arrange-

ments were given no formal shape. They were *ad hoc* improvisations made with the sanction of the Bank of England and the Treasury and intended to apply common sense to the solution of special cases of difficulty which arose from the operation of a rigidly bilateral mechanism such as that of the special account machinery.

It is always a reassuring manifestation of the British genius for compromise that it refuses to be dominated by the strict letter of regulations. If the strict letter of the regulation leads to obviously stupid results there is usually sufficient elasticity in the administration of the controls, and sufficient personal courage and initiative in those who administer them, to discover the interpretation which will ultimately avoid that stupidity. So it happened in this case. Administrative decisions during the years of the war allowed a certain measure of transferability in the use of sterling held by non-sterling countries. And so by a process of mere improvisation was born what was later to become an accepted feature of Britain's payments agreements and exchange control machinery, the principle of administrative or controlled transferability of sterling held by countries outside the sterling area.

To mention these, however, is to run a little ahead of our schedule. One important step which formally acknowledged a wide measure of multilateral use of sterling among non-sterling countries was taken in May 1941 when no less than twelve Central American countries were brought into the bilateral system of payments but were treated for this purpose as a single unit.

Sterling accounts opened in name of their nationals or banks were regarded as 'Central American accounts', and it was provided that transfers might be made freely from one Central American account to another. Much later, in July 1945, these Central American accounts were grouped together with United States registered accounts into a single group known as 'American accounts'. This in fact meant that these Central and one or two South American countries were regarded as an inherent part of the dollar area and that any sterling accumulated by them on current account was in fact convertible into United States dollars. You should, however, note that an important

change was introduced into the convertibility position in July 1945, namely, that the convertibility of such sterling was from then onwards guaranteed only at the official rate ruling at the time of conversion and not at the rates ruling when the registered accounts were inaugurated, which was the case previously.

Let me briefly summarise the position as it obtained at the end of the war. First you had the sterling area, within which movement of funds was free at least as far as Britain was concerned. It was only in very exceptional and highly marginal cases, such as capital movements from Australia, that any restrictions on the movement of funds within the sterling area could be said to exist. Outside the sterling area you had the American account countries and the Swiss accounts. The sterling in these was freely convertible into U.S. dollars and Swiss francs respectively. You then had a large number of special account countries, ostensibly operated on a country-to-country bilateral basis. This meant that Portuguese sterling, for example, could only be used for transfer from one Portuguese account to another or for payments between Portuguese accounts and sterling area accounts. But by dint of experience and adjustment to changing conditions a fair measure of transferability had in fact developed between various types of special accounts. One example will suffice—the sterling held for account of nations in the Scandinavian countries was made available for current payments to Brazil.

With the end of the war the whole range of payments agreements had to be re-negotiated. In this process two broad considerations had to be kept in view. The first was that the new payments agreements would have to be the means of financing a much more normal flow of two-way trade between the sterling area and each of the countries concerned. The second was that the character of the re-negotiated agreements would have to take some account of the advance towards free convertibility of sterling which Britain in any case intended to make, but which in the course of the Washington Loan negotiations towards the end of 1945 was forced upon us at a pace which had not been previously been anticipated.

The first requirement, namely, that the new agreements

should serve a more normal flow of character and trade, required that each party to these payments agreements would make available to the others a certain and defined amount of overdraft facilities. The time when the accounts could be allowed to run indefinitely in one direction, and when countries were prepared or could be compelled to hold unlimited amounts of other's currencies, had obviously gone. This fact had to be recognised, and whether or not convertibility was being thrust upon us by the United States, Britain had to grant non-sterling countries like Portugal, Belgium, and Sweden the right to convert into gold or dollars their sterling accumulations once they had exceeded a certain figure.

Hints of this new pattern had already become apparent in the arrangements made in 1944 and 1945 with Belgium, Sweden, Denmark, Holland, and Norway. They were later to be followed in the arrangements with Portugal, Switzerland, Czechoslovakia and a number of other countries. The need to offer convertible sterling was, however, most clearly illustrated in the negotiations with Argentina which took place in the autumn of 1946. The agreement signed in September of that year provided that all sterling received by Argentina as a result of current transactions anywhere would be freely available either to make payments to sterling area countries or to be transferred to an American account, which meant of course that this sterling was convertible into dollars, or at the option of the Bank of England might be convertible into gold. This liberal concession to Argentina has often been described as the first payment that had to be made in respect of our promised undertaking to the United States to make sterling freely convertible within one year of the ratification of the loan agreement. I doubt myself whether, in the circumstances of 1946, we could have got away with any other arrangement with Argentina, whether or not an Anglo-American loan agreement had been signed. We still depended on Argentina for essential supplies of foodstuffs and were still unable to meet anything like the counterpart of those imports by a corresponding volume of the exports that Argentina required. The time had gone when allied control of shipping and raw material resources enabled us to compel Argentina to accumulate this

favourable balance of payments with the sterling area in blocked sterling. We wanted their meat, we had to offer goods at competitive prices or convertible sterling. When, therefore, you study the figures of gold losses sustained by Britain in 1947, and measure the cost in gold of the convertibility of sterling, beware of the all-too-easy tendency to put most of the blame on the Anglo-American loan agreement. Undoubtedly it caused us to hurry unduly, to run before we could walk. But some measure of convertibility of sterling would in any case have had to be granted to countries with which we were running serious deficits in respect of the import of basic commodities.

The next and, from our point of view, perhaps the most important phase of evolution in the payments agreements made by this country took place early in 1947 with the introduction of what was known as the 'transferable accounts'. A number of countries with which we had negotiated bilateral payments agreements were given the right to transfer sterling among themselves without any reference to the Bank of England, but provided those transfers were in respect of current transactions and were of course duly approved by their own authorities. The initial members of this transferable account system were Argentina, Canada, Newfoundland, and the Belgian, Dutch and Portuguese monetary areas. This was a big step taken in the direction of making sterling more freely available for multilateral payments in the world outside the sterling area. Remember, also, that that was a period when the British Government were making all the necessary preparations for achieving the convertibility of sterling in July 1947. The loan agreement with the United States had been finally ratified by Congress on 15th July 1946, and a year from that date, that is, on 15th July 1947—very close to Independence Day, you will note, but whose independence this was to celebrate was not particularly clear—convertibility of sterling was to become an established fact.

It was thought by the financial authorities in Britain that rather than wait until 15th July 1947 in order to raise the curtain dramatically on a fully convertible pound, it would be better to proceed gradually and in advance of that date and

make sterling convertible over ever-widening parts of the world, until on 15th July nothing more would be required than the formal acknowledgment of an already accomplished fact. As part of this preparation it was decided to make sterling held by transferable account countries fully convertible. This was done by permitting transfers of such sterling, not only within the group of transferable account countries, but from transferable accounts into American accounts. The only formality needed in such transfers from transferable to American accounts was that a subsequent report of it should be made to the Bank of England.

Between February 1947, when the system was introduced, and the great date 15th July, a considerable number of countries were elected to membership of this system. Among them Brazil, Spain, Czechoslovakia and Norway. The policy pursued was to allow the entry of any country which was not desperately short of sterling and whose monetary authorities could be trusted to exercise reasonable control over the manner in which their nationals used their sterling balances. I might perhaps explain why countries which, like France, were short of sterling were not immediately accepted into the group. Britain's payments agreement with France was bilateral in character and, following the normal pattern of these arrangements provided for by some gold payments by France to us when defined margins of credit facilities had been exhausted. If France had been free to receive payment in sterling from all and sundry in respect of current transactions, that might well have deprived Britain of gold receipts which would otherwise have accrued.

You will see that even in those days we had to be very careful about the golden guineas.

By 15th July Britain, either through admission to membership of the transferable account system or in some cases by the grant of administrative convertibility to a few small countries, had in fact extended convertibility to the whole wide world. There were a few exceptions to this, and notably with countries like China, Greece and Hungary, where political and financial conditions made it impossible to negotiate the necessary convertibility arrangements. In the case of France, too,

negotiations were still in progress on the date in question. But by and large we could satisfy the United States that our part of the bargain to the loan agreement had, in this particular respect at least, been duly honoured.

Unfortunately it was not to remain honoured for long. The era of convertibility proved very short-lived, and by the 20th August the convertibility of sterling into dollars had to be suspended. Only one switch had to be pulled in order to achieve this, namely, stopping the free transfer of sterling from transferable to American accounts. And that in fact was the manner in which this great and momentous decision on 20th August 1947 was announced to the world.

It does not fall within my terms of reference today to discuss the whys and wherefores of this cutting short of the great experiment of convertibility, but it would be remiss of me to dismiss it without further comment. We were of course unready for it, and the best proof of that is surely to be found in the fact that now, more than two years after that episode, we still find it as difficult as ever to meet the deficit in the sterling area's balance of payments with the dollar world.

But if I had to give one single explanation of the mishaps of 1947 it would be this—that sterling should not have been singled out as the unique beneficiary of this compliment and this test. The dollar was, and remains, in scarce supply. The moment you set up an automatic convertibility link between dollars and sterling but abstained from throwing similar bridges between the dollar and the other principal currencies in the world, you were bound to throw on sterling a very great deal of the pressure for dollars. Every country in the world strove to gain possession of sterling, whether by influencing its current trade with the sterling area or by digging unexpected amounts of sterling out of hoards, in order to obtain dollars. Admittedly, the loan had provided some dollars in order to underpin and make possible this convertibility. But the loan was already inadequate to meet the direct requirements of Britain. When it was also called upon to meet the requirements of the whole world it vanished almost overnight—and can anyone wonder at it?

With the suspension of convertibility the British Treasury

and the Bank of England, who had spent rather more than a year negotiating new agreements anticipating this convertibility, saw the whole of their work collapse like a pack of cards and had to set to and start all over again. Those who had engineered the convertibility arrangements, and in particular the system of transferable accounts, had, however, built better perhaps than they knew. The essential outlines of this transferable account system remained even after convertibility had disappeared, that is, after the facilities by which sterling in these accounts could be transferred to American accounts had been withdrawn.

The point that was to be decided was whether sterling, after its shaking in the convertibility crisis, could still stand the strain which this transferable account system was bound to put upon it. You must realise that to leave the initiative in the international use of sterling to authorities other than your own is inevitably to make an act of faith. Throughout the period of sterling exchange control the authorities in this country have been torn between the dilemma of making that control really effective and of retaining for sterling some of its old prestige of being a truly international currency. The two things are not necessarily compatible. If one wanted a 100 per cent efficiency in the exchange control the best way to achieve it would be to restrict the use of sterling outside the sterling area to strictly bilateral arrangements under which every operation would take place under the eagle eye of the exchange control authorities in this country. But let honour be given where honour is due. The wider vision has prevailed—not always as quickly as might have been desired, but, given the precariousness of our reserve position, with a welcome readiness to take reasonable risks and in spite of the punishment which has occasionally had to be taken. This elasticity and willingness to take some risk have been evident, firstly, in the extent to which the Bank of England has delegated the work of control to the commercial banks, to the so-called authorised banks. Secondly, it has been apparent in the decisions which have been taken to allow sterling to be used for multilateral payments outside the sterling area without continuous authorisation of the exchange control authorities here.

After the convertibility crisis it was decided to leave the transferable sterling account in being, although not without some appreciable amendment. The new guiding principle followed in deciding on the admission or exclusion of countries to or from the transferable account was whether or not they were in approximate balance in their current payment with the sterling area. The reason for this is fairly obvious. You must recall that the transferable account system was superimposed on the existing bilateral payments agreement between Britain and the countries which were invited into the system. This meant that any country acquiring sterling through its membership of the transferable account system might be able to claim gold from Britain if its sterling holdings were increased beyond the gold ceiling or gold point incorporated in most of these payments agreements. No such untoward and undesirable consequence of the automatic transferability of sterling would occur if membership of the transferable system were restricted to countries which would need something like their current earnings of sterling in order to meet their current outgoings. This obviously debarred one or two countries, including some countries which had previously been in the transferable account system. The most important of these was Belgium, which, as we now know, had profited quite markedly by her membership of the transferable account system over the first few months of 1947. She had been paid in sterling for a large part of her surpluses with other countries in the system, and had thereby been put in a position to accumulate sterling beyond the gold convertibility point and thus demand gold from Britain. Belgium, therefore, was asked to leave, while at the other end of the scale France, an example of the countries with chronic sterling deficits, stayed out.

In spite of this restriction of membership of the transferable account system to countries which are in rough balance of payments equilibrium with the sterling area, some risks were bound to be incurred in tolerating this delegation of authority about the use of sterling to other countries. This was part of the risks inevitably involved in the choice I have already mentioned to you: the choice between re-creating the position of sterling as a great international currency and the desire to

have complete supervision and 100 per cent efficiency of the sterling exchange control. The moment you allow sterling to be transferred freely and without reference to the Bank of England between countries as diverse in their character and philosophy as Egypt, the Netherlands, Czechoslovakia, Norway and Soviet Russia, you inevitably take risks that this sterling may provide the basis for transactions which the authorities in those countries may regard as genuine current transactions but which might not pass the same test here in Great Britain.

I do not propose, in this lecture, to explain the abuses of transferable sterling which have been perpetrated over the past few years, or to describe the ingenious triangular transactions by which certain countries in the transferable group have been able to earn hard currency profits which should have been going to the sterling area itself. It would be presumptuous of me to give any such explanations to an audience which contains Continental bankers. It would be very much like teaching my grandmother how to suck eggs. Nor will I enter into the tortuous debate as to whether foreign countries which have indulged in this triangular trade and have been pushing the exports of sterling area goods to the hard currency countries have in fact done Britain good or evil.

There are things to be said on both sides. All I will say on this subject is to make a very general observation, namely, that these ingenious and, for some, profitable deals are in themselves the symbol of disequilibrium in world prices and of artificiality in exchange rates. If there were no such disequilibrium, if exchange rates were established at somewhere near the economic parities, there would be little or no scope for the ingenuity of those merchants who have been able to buy in terms of sterling to sell against dollars and, through various devices, including the facilities of transferable sterling, have been able to re-convert their dollars into sterling at more profitable rates than the official parity. All that has happened in this respect is that the countries with the more rigid supervision of exchanges have lost the profits to the benefit of those which in these matters have been a little more accommodating.

This, however, was a problem which the British authorities could not altogether ignore, especially in view of the impact of

other factors making for an acceleration in the drain of the sterling area's gold reserve. The measures taken to remedy this position were at first in the nature of exhortations and invocations for fair play. The erring countries were told by the Bank of England that they were not playing the Bretton Woods game, and that they were in fact tolerating disorderly cross rates and operations in exchange which diverged considerably from the official parities notified to the International Monetary Fund. These appeals, I need hardly add, had very little effect and they had to make way for more decisive action.

Among these measures was the use of Britain's bargaining weapon as a creditor country in intra-European payments. France and Italy were two of the countries which had tolerated free markets in which the cross rate between pounds and dollars was considerably lower than the official parity. They were also two countries to which Britain was being asked to grant considerable contributions under the Intra-European Payments Scheme. It is hardly surprising that they should have been asked, in exchange for those benefits, to give up the toleration of a practice which appeared to be injurious to sterling area interests and derogatory to the prestige of sterling. They did so, and in the amended exchange arrangements which these countries introduced last year the so-called disorderly cross rates disappeared, although I would not go so far as to claim that all practices of which Britain had complained were also abandoned. In the case of Italy, the acceptance of this condition was made a prerequisite of her admission into the transferable account group.

In addition, the British authorities have also taken measures to restrict the freedom with which sterling can be shunted around within the transferable account group of countries. These measures first found the light of day in the new payments agreement signed with Egypt in the early part of this year. This provided that sterling could only be transferred from an Egyptian account to that of another country in the transferable account group in payment for a direct commercial transaction between those two countries. Egypt, for example, would only be allowed to transfer sterling to a Dutch account in respect of an import from the Dutch monetary area

to Egypt. This should have terminated the practice under which Dutch banks, for example, had been prepared to open sterling accounts for Egyptian clients, a practice which had become significantly popular in the preceding months.

It seems to be the policy of the British authorities to apply this restriction of transferable sterling to all countries in the transferable account group. This will be done as and when payments agreements with these countries lapse and have to be re-negotiated. This, you will agree, is a retreat from the ideals of the free and multilateral use of sterling outside the sterling area itself, and from that point of view is a retrograde and regrettable move. It should, however, be realised that in the abnormal circumstances of 1949, and given the added strain on the gold reserve, this defensive move was probably inevitable, and may perhaps be regarded as an example of *reculer pour mieux sauter* once the conditions for leaping ahead are again propitious.

I should add that considerable use has been made of this transferability of sterling—whether automatic or administrative—outside the sterling area itself. The Bank of England, in its last annual report, stated that the amount of sterling which had been transferred by countries outside the sterling area among themselves was £240 million in 1948. This excluded all transfers to and from American account. It represents, therefore, the extent to which sterling was in effect used as an international currency outside the realms of the sterling area. This, it must be admitted, was a remarkably good performance. Of the total of £240 million no less than £152 million was transferred by the use of special administrative facilities. This shows how liberal the authorities have been in sanctioning the use of sterling by countries outside the transferable account group, and have thus been prepared to take risks in the cause of increasing the wider multilateral use of sterling in international trade.

I have spoken at some length on the transferable account system because I feel that it is in this sector of Britain's payments agreements and arrangements that we can begin to discern the design by which sterling may again become a truly international currency and through which it may attract to

itself a number of countries outside the present sterling area. Beyond this group of transferable account countries, which now numbers fifteen, and which you will find enumerated in the chart prepared by the Midland Bank and circulated to you as part of the documentation for this series of lectures, there is an even larger group of so-called bilateral accounts. These countries are those with which sterling payments arrangements are made on a strictly bilateral basis. Argentina, for example, with which a new commercial and financial agreement was recently negotiated, transacts its operations with the sterling area through sterling accounts, the use of which is strictly restricted to payments to and from Argentina and the sterling area.

In the case of Argentina the sterling accumulated in these accounts has the benefit of exchange guarantees which vary according to the account. With most other countries in this group there are no such devaluation guarantees, but provision is made that sterling held by them becomes convertible into gold when it exceeds a certain figure. You should note that within this group of bilateral accounts there is in fact a wide measure of transferability, but always subject to the control and consent of the Bank of England. This is the principle of 'administrative transferability', or 'controlled transferability' as it is sometimes called, which began to be introduced in the special account system during the war in order to give that system some measure of elasticity and some resemblance to a network of multilateral payments. Authorisations for transfers of sterling within this group are given on a fairly wide scale, and by extending these facilities it is possible to convert this large group of bilateral account countries into something closely akin to the transferable account system. At the least the countries in this group maintain the habit of using sterling for some of their international transactions, and if this habit is not completely lost there is always the hope that it may revive and re-acquire some of its age-old importance.

I have as yet said nothing about the payments arrangements within the sterling area or the 'scheduled territories', as they have been unromantically christened since the enactment of the exchange control Act in October 1947. I shall necessarily have to deal summarily with this part of our subject, not only

because time is getting on but because the departures from the normal are somewhat artificial and, although important in their particular context, are of no special significance from the point of view of Britain's payments agreements as a whole. The general principle is that within the sterling area payments for current and capital transactions are free. There is, however, a substantial amount of sterling held on sterling area account which is not free but which is held in so-called No. 2 accounts in the Bank of England. In order to get this technique in its proper perspective you should understand that there are, broadly speaking, two kinds of members of the sterling area. There are those who are trusted to use their accumulated sterling resources and to dip into the sterling area dollar pool in accordance with their free discretion. There are others whose access to accumulated balances and to the common reserve of the sterling area is circumvented by agreements which provide for annual releases from their accumulated balances and annual quotas of hard currencies. All members of the sterling area are, of course, free to use their current sterling earnings for payments within the sterling area, or to countries in the bilateral group or in the transferable account group of countries. Those countries which have immobilised sterling for the most part use that sterling in Treasury Bills and the income on these is credited to their No. 1 account, that is, to the sterling which they can use freely.

The main departures from this normal practice are those which apply to payments with and from South Africa, a country which by reason of its predominance as a gold producer is always likely to be a slightly odd member of the sterling area family, particularly in its relations with the sterling area dollar pool. The only general observation I would make about the experience of the sterling area mechanism over the past year or so is to say that it has revealed both its strength and weaknesses.

In a world of increasing exchange difficulty and of growing dollar scarcity the sterling area has unquestionably provided the one example of a large and widely scattered group of countries within which there has been reasonable multilateral freedom of payments and freedom of trade. At the same time

the serious depletion of its central gold and dollar reserve has faced all its members with a very severe test of their loyalty. The voluntary cohesion of that area has not emerged altogether unshaken from this test. The distribution of sacrifices is always an ordeal of self-discipline, especially when it has to occur among a group of countries so widely contrasted in political, racial and economic conditions as are the members of the sterling area. By and large this test has been surmounted and has revealed above all things the recognition by all these countries that they stand to lose far more than they would gain by a disruption of the sterling area. Many of their eggs are in the sterling basket, and they have shown an understandable solicitude for cushioning the blows which have fallen on the central reserve.

I still have said nothing about the chapter in Britain's payment arrangements which is concerned with the Intra-European Payments Scheme. If I were to explain this fully we would still be here in an hour's time. I do not think we need go into the tortuous details of this scheme, with its category 1 and category 2 compensations, its contributions and its transferable and non-transferable drawing rights. The scheme is an excrescence on the normal payments machinery of Britain and Europe as a whole. It is the product of disequilibrium, and though it has done valiant work and provided the means for rescuing European trade from a stranglehold into which it was held in 1947 and early 1948, it need hardly be regarded as more than a curiosity and as the product of the wholly abnormal circumstances in which postwar Europe found itself. I do not think it has anything of permanent value to teach us other than to reveal the beauty of the international payments machinery which used to take these problems and conundrums in its stride.

This is the note on which I would like to end this lecture, just as it is that on which I began it. The maze of payments agreements, of compensation schemes and of other payments devices in which we find ourselves today, and through part of which I have been guiding your footsteps, is a symbol of the straits in which we in this country and a large part of the world find ourselves. The study of its complexities must, as

I said before, fill us with a sense of reverence, not so much for the international mechanism which used to do that work so smoothly, and with such impersonal efficacy, as for the natural balance and equilibrium in balances of payments which made the functioning of that mechanism possible. That balance and equilibrium was the product of a certain amount of external dictation. It was the result of a subordination of domestic economic policies to the criterion of external forces, to the desire for keeping in step with the other countries of the world. This subordination may have had some defects, but do not forget that it also achieved great things. It created the atmosphere of international stability in which the commercial and financial development of the nineteenth and early part of the twentieth century found its setting. And that was a period when economic progress in the world made strides never previously and never since achieved.

Intra-European Payments

By

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It is said that during the recent negotiations in Paris for the renewal of the Intra-European payments agreement the cables sent home by the British delegation became so incomprehensible even to their expert colleagues in London that a member of the delegation had to be sent home to interpret them. That sufficiently illustrates the incredible complications of the scheme in its detailed working. However, it is not on the technicalities that I wish to dwell in this lecture. The subject is admirably documented and those who wish to study it in further detail can readily do so from a variety of sources.* In its principles and application the plan is in any case really quite simple and it is these wider questions of principle that it is proposed to examine here.

My purpose is to show that the present complicated arrangements are a direct outcome of the monetary disorders of this postwar world. The mere fact that such a scheme has been found necessary is a reflection of Western Europe's lack of adequate gold reserves, and this in turn is merely one aspect of the most important of all our monetary problems, namely, the world dollar shortage; but it involves also such domestic European questions as the present disparities in the price levels of the various countries—which is, of course, only another way of referring to the artificiality of the structure of exchange rates. Seen in this way, a problem in monetary theory and practice, the subject is of more than ordinary interest to bankers as

* In particular are recommended:
Committee on Payments Agreements (two reports).
Bank for International Settlements, 18th and 19th annual reports.
Economist, January 29 and February 5, 1949.
World To-day, August 1949.

emphasising the supreme importance of a properly functioning monetary system. If it were necessary to show how the traders of the world can be thwarted and frustrated by the lack of an internationally acceptable medium of payment, and how this strangulation of trade can be averted by the erection of improved financial arrangements, one could not find a more cogent example than the state of Europe during these last four years.

To study the genesis of the present scheme we have to cast our minds back to the autumn of 1947, the period after the brief experiment in sterling convertibility had to be abandoned and before the European Recovery Programme had been accepted by Congress. Due to the devastation of war, a miserably poor harvest and the Iron Curtain barrier to east-west trade, all the countries of Western Europe were hoping to obtain American and other Western Hemisphere goods and services vastly in excess of their ability to earn dollars from their export trade. Yet apart from such current earnings the only method of effecting payments to the dollar area, but for the Marshall Plan, would have been through the shipment of gold to the United States; and their gold reserves were in many cases nearing exhaustion and in all cases quite insufficient to meet the prospective dollar deficit. The first characteristic of the situation, then, was an extreme scarcity of gold (though it should be noted in passing that while gold remained a universally acceptable, and indeed highly sought after, commodity, this was only in virtue of its convertibility into dollars. Europe was on a dollar standard).

Secondly, while the export potential of Western Europe as a whole had been greatly impaired by the war, some countries had been less damaged or had made a more rapid recovery than others. Physically, these countries would have been in a position to export to their neighbours; but in doing so they would have sacrificed either goods urgently needed for their own reconstruction or else the opportunity of using their exports to earn dollars which in turn could have been turned into urgently needed goods. There was thus an extreme but very natural reluctance to make 'unrequited' exports, that is, to export to other countries except in return for goods or gold,

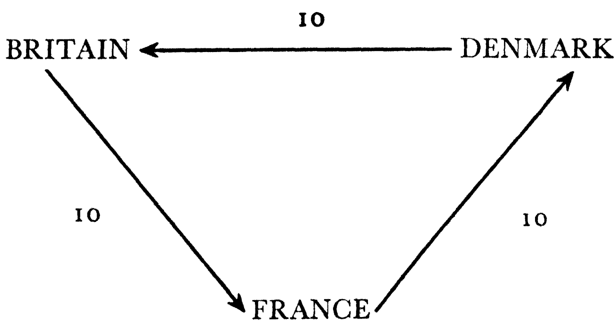
the equivalent of goods. This was not mere selfishness. It must be remembered that in varying degrees all European countries were still in the throes of inflation, and every unrequited export would merely aggravate the inflationary pressure. Fortunately, we were not confronted with an outright refusal to make any unrequited exports at all, which would have throttled intra-European trade almost entirely by reducing it to a purely barter basis. To some extent the flow of trade was maintained by the grant of limited credit under bilateral agreements, the so-called 'Spitze' agreements between pairs of countries which required only the excess over a certain agreed balance either way to be settled in gold. In the autumn of 1947, however, even these bilateral credits were becoming almost used up as some countries—those which were worst hit or had done least to stem inflation—tended to become debtors to all their neighbours. A real deadlock in intra-European trade due purely to these payments difficulties was thus an imminent danger.

The solution which has been found falls logically into two separate parts, though they have been welded into a single whole. They are, first, the clearing scheme operated by the Bank for International Settlements and, secondly, the Marshall Plan system of intra-European grants and drawing rights which has been grafted on to the clearing. Let us consider first the clearing scheme. It is this which gives rise to all the complications of the subject, with its specialised jargon of 'first-category compensations' and so forth. Yet in essence its purpose and advantages are precisely those of an ordinary cheque clearing inside a country: namely, to economise in the use of cash, which in the sphere of international trade means the need for gold transfers. Both its usefulness and its limitations can be illustrated by two simple examples.

Let us suppose that our trading system comprises only three countries, Britain, Denmark and France. Bilateral agreements have been concluded between each pair of countries providing that each will hold the currency of the other up to a maximum of £10 millions or its equivalent; and the flow of trade has been such that Britain owes France £10 millions, France owes Denmark the equivalent of £10 millions in French francs and Denmark owes Britain the equivalent of £10 millions in Danish

kroner. In other words, we have the situation shown in Diagram 1. In the absence of a clearing, a continuance of trade, following the same channels would have caused an increase in indebtedness beyond the limits prescribed in the bilateral agreements, calling for gold transfers; in default of these it would have been necessary to ensure bilateral balance between each pair of countries, with a consequent shrinkage in the volume of trade. If a clearing is instituted all three debts cancel out, the original margins of credit under the bilateral agreements become available once more and trade can proceed undisturbed.

Diagram 1

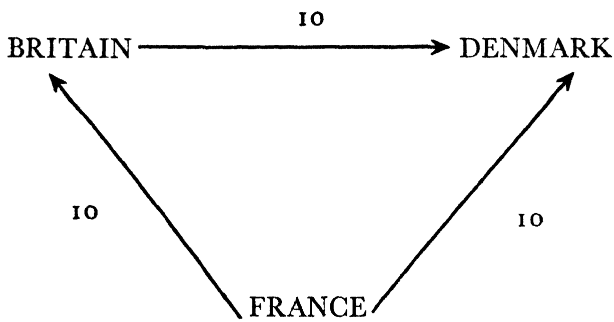


This was an example of a so-called 'first-category compensation'; that is, a settlement which does not result in an increase of the balance due to any member of the clearing in any particular currency. It will be seen that we assumed that the debts owing by each country exactly equalled the debts due to it: there were no 'ultimate' debtors or creditors. It is in these conditions that a clearing can operate with least difficulty. Where currencies are inconvertible, however, problems may arise even in a situation of that kind. In our example, bilateral agreements had been concluded providing for a mutual grant of credit up to the amount of the balances in fact owing. Suppose on the contrary that France had no such agreement with Britain, but could call for settlement of this country's adverse balance in gold. In that event she would naturally be unwilling to allow her debt to Denmark (which is willing to

accept francs) to be offset against her claim on Britain, losing gold in the process. It is basically for this reason that balances due from certain creditors (Belgium and Portugal), whose currencies are virtually equivalent to gold, are excluded even from first-category compensations.

With inconvertible currencies, the possibilities of clearing become even more limited if some members of the system are on balance net debtors or net creditors. Diagram 2 shows a situation in which France is a 'universal' debtor to both the other countries and Denmark a universal creditor. If Britain's debt to Denmark were offset against her claim on France, this

Diagram 2



would leave Denmark holding the equivalent of £20 millions of French francs instead of £10 millions of francs and £10 millions of sterling. Since the 'credit standing' of the different European currencies varies widely such a substitution might not be acceptable to the creditor country. Nor would it suit the debtor country if, as we supposed in our previous example, any balance in excess of £10 millions had to be settled in gold. Under the system of bilateral agreements it is advisable to keep one's indebtedness well spread, since any accumulation of one's currency in the hands of a single creditor is liable to cost gold. That is why 'second-category' compensations are permitted only with the approval of the parties concerned. And it is, of course, the fear that sterling might gravitate unduly into the hands of creditor countries such as Belgium which

explains this country's unwillingness to commit itself to any automatic clearing of balances.

Those requiring a deeper insight into the complexities of clearing would do well to study the documents recommended earlier, but the basic problems are those discussed above. We have seen that compensation can be of enormous value in lubricating and stimulating the flow of trade where it effects an all-round reduction of the balances to be settled; but we have seen also that where this is not the case the possible usefulness of the clearing is severely restricted by the inconvertibility of the currencies in question, just as it would be difficult to operate a successful cheque clearing between banks possessing virtually no cash reserves. That the scheme has been able to make so valuable a contribution as it has to European trade—up to 30th June it had settled £170 millions worth of transactions—has been due to the incorporation in the clearing of the system of contributions and drawing rights which now forms an integral part of the Marshall Plan.

It is no accident that from the earliest days the Marshall project has been closely linked with the problem of intra-European settlements. The primary object of the plan, as we all know, is to render the recipient countries independent of American aid by 1952. That aim can scarcely be realised without some degree of integration of the economies of the various countries, and this in turn demands a free and expanding interchange of goods and services between them. Yet as we have noted earlier, there was a real danger that intra-European trade, so far from increasing, would actually suffer a serious contraction, due to the general inadequacy of gold reserves coupled with a universal reluctance to export goods in return merely for a credit in inconvertible currency. The key to the problem, though not the whole solution, was clear: To avert such a breakdown it was necessary above all to devise some arrangements by which a country making unrequited exports to the rest of the Marshall area would in effect be earning dollars for itself. It was natural to seek to harness the prospective Marshall Aid to serve a purpose so germane to the ultimate objective of the whole recovery programme.

The case for doing so was admirably expressed by the Com-

mittee on Payments Agreements in the following passage of its first report:

'The primary purpose of American aid is to enable the participating countries to obtain from the American continent what is needed for their production programmes. But a number of the Governments represented on the Committee desire that American aid should serve a double purpose and also be used to reduce payments difficulties as between the participating countries and restrictions on the interchange of goods and services between these countries, so far as these restrictions arise from payments difficulties.

'Accordingly, these Governments desire that some part of American aid should take the form of dollars which can be used, first in making payments for goods supplied by one of the participating countries (including Western Germany) to another, and subsequently by the country which receives such payments to cover supplies from the American continent. It is, for example, clear that if one of the participating countries has coal or steel which it is able and ready to sell to another participating country, the latter should not be compelled by payments difficulties to refrain from buying steel or coal from a participating country and be forced to continue to buy them from the United States. This would be inconsistent with the programmes formulated by the Technical Committees of the Paris Conference, which assumed that no payments difficulties would prevent participating countries from supplying key commodities to each other.

'To achieve the desired result it is not suggested that additional American aid should be granted but that American aid should be so arranged that it will serve both purposes instead of one purpose only.'

Unfortunately, the Act which ultimately emerged from Congress was not particularly well adapted to achieving this dual purpose of freeing intra-European trade and helping to restore the convertibility of the recipients' currencies in addition to bridging their dollar deficits. Indeed, its underlying conceptions and procedures, with the allocation of aid between countries to be based purely on their prospective dollar deficit and the detailed appropriations to be earmarked for the pur-

chase of particular parcels of commodities, seemed at first altogether incompatible with the notion of infusing a dollar incentive into intra-European trade. Even within this unpromising framework, however, it has proved possible to evolve an adequate if not perfect solution, sufficient at any rate to keep trade moving.

Discussion of the possible use of Marshall Aid for restoring the convertibility of European currencies between themselves at first took the form of suggestions for the establishment of a European stabilisation fund, which would enable the countries concerned to convert their holdings of each other's currencies into dollars. The Paris report proposed, indeed, that a sum of \$3 billions should be employed to this end. It was clear, however, that if the total Marshall Aid was to be strictly limited to the size of Western Europe's prospective dollar deficit, then any dollars originally placed in such a fund would rapidly be spent and find their way back out of European hands to the dollar area. The Fund could only hope to remain in existence if *additional* dollars were provided for its establishment, over and above those provided for the finance of the current dollar deficit. The Harriman Committee accepted the principle that 'the financing of European imports from other countries is just as important to the recovery programme as the financing of United States exports'; but it was not prepared to recommend a special allocation of dollars as a stabilisation fund, on the grounds partly that the U.S.A. had already paid \$2¾ billions into the International Monetary Fund for this general purpose.

Nevertheless, it is important to note that stabilisation loans are not ruled out for all time. On the contrary, President Truman in his message to Congress recommending the adoption of the Economic Co-operation Act explicitly stated that, while the bill did not mention such loans, the State Department believed that '. . . they would play a useful role in European recovery. They are not being requested at this time, because it has not been found possible to state with any accuracy the amount it would be desirable to provide. When countries have taken major steps towards internal and external monetary equilibrium the administrator will consult with the National Advisory Council. Supplementary legislation will then be in-

troduced authorising an increase in the United States stabilisation fund to allow it to make a stabilisation loan.' This undertaking might clearly assume considerable importance in the near future.

Even if a stabilisation fund had to be ruled out, there remained the possibility, as suggested by the Committee on Payments Agreements, of making the available aid serve a dual purpose by allowing some of the dollars to be used in the first instance to finance trade between the participating countries and only in the second instance for the purchase of goods from the dollar area. Originally this was done through the system of 'off-shore purchases', which enabled the participants to use E.R.P. dollars to purchase supplies from other European countries, and for a time in 1948 the E.C.A. directly financed a part of intra-European trade in this way. Clearly, this was one way of solving the basic problem of inducing the European countries to make what would otherwise be unrequited exports to each other by offering them a dollar incentive, since the effect is to transfer to the exporting country, in exchange for its goods, dollars originally allocated to the importer. But this particular method—though attractive to the exporting countries who were thereby enabled to earn not only dollars but *free* dollars—had definite limitations and disadvantages.

In the first place it is clearly undesirable that European currencies should be entirely replaced by dollars in the finance of intra-European trade. The object should rather be to use the available dollars in such a way as to enhance the transferability of the European currencies themselves. Secondly, the transaction could only be attractive to the importing country if it meant an equivalent reduction in its dollar requirements. If the cost of the goods, converted into dollars at the official rate of exchange, were higher than that of the American goods they replaced, then the importer would lose dollars on balance and the Marshall Aid remaining to it would become insufficient to cover its dollar deficit. Now, at the official rates of exchange the dollar was deliberately undervalued, with the tacit approval of all parties, in order to promote a large American export surplus. This meant that, at the prevailing rates of exchange, American prices usually tended to be lower than

European prices, so that the scope for advantageous off-shore purchases within Europe was necessarily limited.

Moreover, if we ignore this problem of the disparity between American and European price levels, we come upon a more fundamental difficulty, which I had in mind in saying that the provision of a dollar incentive to unrequited exports was only the key to the problem and not the whole solution. Suppose the conditions were such that the European debtor countries could freely use part of their Marshall dollars to pay for their import surplus from the other participants. Obviously, the latter then have a strong incentive to achieve as large an export surplus in their European trade as possible. To the extent that this came about through an expansion of exports the results would be wholly admirable; in addition to keeping trade moving we should be infusing a healthy element of competition between the different exporters, helping to bring down their costs and improve their efficiency. Unfortunately, there is another side to the picture. There would also be a tendency for all countries to cut down their purchases from the rest of Europe, in order to widen still further the export surplus eligible for reimbursement in dollars or to reduce the import surplus responsible for the drain on their Marshall allocations. For a complete solution, in fact, we require not only a dollar incentive to export to Europe but also a dollar incentive to buy from Europe. On balance there is a probability that the possibility of earning *unlimited* dollars by exporting to the rest of Europe, unaccompanied by any other provisions, would produce a deflationary spiral in intra-European trade instead of an expansionary stimulus. The position would be identical with that sometimes seen in the past, at times of depression due to a collapse in American imports and accompanied therefore by a severe shortage of dollars, when in the vain hope of earning surpluses convertible into dollars the remaining countries have cut down imports from each other as well as from the dollar world, with disastrous consequences for the volume of international trade.

This very serious pitfall is avoided in the device which has superseded intra-European off-shore purchases, namely, the system of conditional aid. As is well known, the prospective

creditor countries have agreed to make outright grants to the prospective debtors up to a fixed annual sum determined in advance. On the other hand, an equivalent part of the Marshall allocation to the creditor countries takes the form of conditional aid; its extension is in principle conditional, that is, upon the drawing rights granted to the debtor countries in fact being utilised.

Up to a point, this is clearly quite a useful method of injecting a dollar stimulus without serious deflationary dangers.* The creditor countries have every incentive to make unrequited exports on the scale envisaged in order to earn their conditional aid, but this stimulus ceases abruptly as soon as the export surplus equivalent to the conditional aid has been achieved. The debtors for their part have no incentive to reduce their balance of payments deficits with the creditors. On the contrary, the governments of the beneficiary countries have every incentive to take advantage of the drawing rights extended, since from their point of view the goods obtained thereby represent a free gift. It must be remembered, however, that the goods have eventually to be sold, like any others, on the domestic markets by individual traders. If the prices of the country granting drawing rights are higher than those of similar goods produced at home or obtainable from other sources, there may be no natural demand for them from importers which would enable the government of the country concerned to avail itself of the drawing rights. It could do so only by

* A theoretical alternative might have been to debit European importers at a lower rate, in dollars, for goods purchased out of their Marshall allocations from European suppliers than for goods purchased from the dollar area. In principle this would have provided a dollar incentive to import from other European countries and thus, in combination with the dollar incentive to export already discussed, have avoided the deflationary dangers of the latter on its own. Against such a solution various practical objections can be raised. The burden of Marshall Aid on the American people would no longer be fixed definitely in advance but would be a variable quantity increasing to the extent that European countries were able to meet each other's requirements (since E.C.A. would pay the full dollar equivalent to the exporting country and deduct something less than this from the allocation of the importing country). Such a system would also be a tacit recognition of the artificiality of existing exchange rates between European currencies and the dollar.

such means as discriminatory import quotas or the subsidisation of imports from the country granting the drawing rights (i.e. by selling the relative goods to its own people at a price less than their equivalent cost at the official exchange rate). This may help to explain why drawing rights granted are not always utilised up to the full. It may be noted, too, that such a situation, if it arises, carries certain dangers. If the demand for its products in a beneficiary country is lower than anticipated, a contributing country might tend to restrict its imports from the beneficiary country, to secure a favourable balance by this means and so to make sure of the conditional dollars corresponding to the drawing rights it has extended. This would, of course, be contrary to the whole spirit of the plan and there is no evidence of its having occurred in practice.

To sum up, we can say that from the viewpoint of incentive, the system of intra-European grants and contributions shares the identical defects of the Marshall Plan itself: the aid extended is rigidly fixed in advance on the basis purely of estimated 'needs', with no rewards for good performance but rather the reverse: the bigger the deficit, the bigger the aid. Indeed, even the supposed incentive implicit in the conditional aid system is to some extent illusory, for this forms part of a total allocation which at the best suffices only to cover the prospective dollar deficit. In effect, the creditors are thus being asked to pass on to other countries—in the form of goods—part of their own Marshall Aid. The system embodies penalties for failure to do so, but no rewards.

To this there is one exception. Obviously, conditional aid can be equated to a country's intra-European contribution only so long as that country's prospective dollar deficit exceeds its prospective surplus in European trade. But exactly the reverse is true in the case of Belgium, a large creditor in Europe with a relatively small dollar gap. To induce Belgium to maintain her export surplus to the other Marshall nations she has been offered, over and above the aid needed to meet her actual dollar requirements, a certain sum in 'free' dollars which can be added to her gold reserves. On the other hand, this arrangement is itself a compromise, since the free dollars cover only part of the difference between her European export surplus and

her dollar gap. Part of the remainder will probably be paid for by gold transfers from other European countries; but as a *quid pro quo* for the free dollars Belgium has agreed to extend long-term loans for the balance.

There is another aspect of the scheme which came very much into prominence during the recent Paris negotiations for its renewal. During the first year, the drawing rights extended by the creditor countries were purely bilateral; that is, France could use Britain's contribution to her only for purchases in the sterling area and not for purchases in any other region, even though the goods she requires might be obtainable more cheaply elsewhere. The effect of this, as of any other bilateral arrangement, is to remove the calculus of cost, to make it possible up to a point (as we have seen, there are some limitations) for a country to dispose of goods whether or not they are competitive with other sources of supply. Obviously, it is desirable on general grounds that the intra-European contributions, like intra-European trade itself, should be placed on a multilateral footing, allowing all countries to buy in the cheapest market, providing an all-round stimulus to efficiency and enabling trade to flow in its natural channels. The obstacle in the way is the same as that we encountered when examining the compensation problem earlier on: the fear that multilateral arrangements would entail a loss of gold. To take a specific and very practical example, this country would lose gold if France chose to use her sterling drawing rights for the purchase of goods in Belgium. In the event, the compromise solution has been adopted of rendering 25 per cent of the contributions transferable as between European countries and setting a limit of $40 millions to any resulting gold transfers.

The Americans, as is well known, would have liked to make the contributions not merely transferable within Europe but convertible into dollars. This would have meant that, if any European creditor were to make its intra-European contributions in the form of goods and not of gold, it would have to render its goods competitive not only with those of its European partners but with those of the United States. Given the recent fall in American prices, however, the disparity at existing exchange rates is now so great that European prices

could not be brought down to the American level without an intolerably drastic deflation of credit and the creation of mass unemployment. The moral is obvious: Unless dollars were to be made available on a far larger scale than is provided in the Marshall Plan, the world, even outside the Iron Curtain, must remain divided into two distinct trading areas—a high-cost and a lower-cost area insulated by discrimination and import restrictions—until the present artificial structure of exchange rates is amended and the parities between currencies are brought nearer to their equilibrium level.

It is this artificiality of exchange rates which lies at the root of all the problems we have been discussing. All the complications derive from that basic fact. Within the framework set by present conditions the Intra-European Payments scheme has done valiant service and it is doubtful whether very much further can be done to improve it while those conditions persist. As the Bank for International Settlements says, the scheme has shown itself capable of practical application and 'has helped to sustain the volume of intra-European trade . . . But it can never equal in effectiveness the traditional multilateral settlements which worked so smoothly in the past. Before they can be resumed, however, it is necessary that fundamental equilibrium should be restored within the various economies in a measure not yet attained and that sufficient monetary reserves should be available to cope with normally recurring fluctuations and to strengthen the feeling of confidence.' In short, before we can hope to get rid of the rigmarole of the payments scheme, as of all the other paraphernalia of bilateration, two things must happen: exchange rates must be adjusted and Europe's monetary reserves built up again.

Some Aspects of the English Law of Documentary Credits

By

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THE fact that the English banks (and their Dominion *confrères*) have resolutely refused to acknowledge the Uniform Customs and Practice for Commercial Documentary Credits, formulated under the ægis of the International Chamber of Commerce, is a matter of serious concern to the many foreign bankers who have endeavoured to find some common code of behaviour as a protection against the misunderstanding which is inevitable in a financing operation the variety of whose conditions and circumstances is infinite. Such a code could in time acquire the force of law in the countries adopting it. How far the Uniform Customs have gone in this direction in the United States of America and many countries of the continent of Europe is not certain. While they have not the same force as if they were embodied in statute, they may have the force of custom and, if the courts of those countries were called upon to decide, the weight of their judgment might fall in favour of adherence to the regulations—to put it another way, breach of those regulations might be construed against the banks which set them up. In view of the difference between the British attitude to uniformity on the one hand and the North American *cum* Continental on the other, it may fairly be said that a knowledge of the basic law of Great Britain in this matter is essential to a full understanding of the law governing the finance of foreign trade and, therefore, to an understanding of the practice of financing foreign trade.

I do not wish to be understood as suggesting that the gap between the British and other points of view arises from major

differences in the laws concerning documentary credits. It does not, for the American law, at any rate, is fundamentally the same as the British, and I believe that this applies to many other countries. Practice, however, does differ, and to appreciate the practice it is necessary to understand the laws within which the practice functions.

It has been asserted in America that it is 'commercial practice in England . . . to recognise "received for shipment" and "alongside" bills of lading, "certificates of insurance" and "partial shipments", and the whole purpose of the regulations [i.e., the Uniform Customs] is to conform banking practice to commercial practice and consequently to expedite rather than impede the encashment of customary commercial documents presented in connection with documentary credits'.* If this is true, and implies that banking practice is behind commercial practice in this matter, the claim commonly made in England that the law follows commercial practice seems to need investigation, for here the law and the practice of banking may be said to be generally coincident.

While I have chosen to treat of the fundamentals of my subject, I shall nevertheless try to show some of the differences which exist between the law here and in some other countries and to point the way to that modest degree of uniformity—of that universal uniformity strongly desired by those countries adhering to the Uniform Customs—to which in my view all nations may properly aspire. As the basis of my discussion, I shall deal with one type of credit only, the irrevocable credit, because in its variants it provides for all the relationships I wish to discuss. Moreover, because of considerations of time and because it is not strictly of the law relating to documentary credits, I have not dealt with the subject of the security afforded to bankers by the documents of title submitted under credits. And I wish to say here and now that such expressions of opinion as may emerge are my own and not those of any bank or banks in this country, for none of which have I authority to speak.

A documentary credit has been variously defined, although

* *Bank Credits and Acceptances,* Ward and Harfield (Ronald Press, 3rd (1948) ed., p. 196).

not, I believe, judicially, probably because of the several types which are met with and of the very diverse circumstances which give rise to them. As an example, it may be defined as the written undertaking, given by a bank to the seller of goods at the request of the importer of the goods, to meet bills of exchange drawn by the seller in accordance with the terms of the undertaking, providing the documents of title to the goods prescribed by the buyer are tendered on presentment of the bill of exchange for payment. Succinctly, Gutteridge defines a documentary credit as 'one which provides that the banker's liability to pay or accept the seller's draft is conditional on his being furnished with certain documents (generally a bill of lading, a policy of insurance and an invoice) which are to be pledged to him as security for an advance'. *

The relationships between the several parties to the transaction embodied in a documentary credit are in some respects quite clear. There is no doubt concerning that between the buyer and seller—it is purely contractual, as is that between the buyer and the banker who opens the credit. The former is just what the two parties care to make it; the latter also—though it is in a sense mandatory, for the banker is instructed as the buyer's agent to initiate a transaction by which the seller may receive payment. The buyer indemnifies the banker in respect of his paying the seller, such indemnity being dependent for its validity on the banker's complying strictly with the mandate. But it is the relationship between the banker and the seller that is less easy to define legally, at any rate in countries in which the English common law is the foundation of that of documentary credits.

The conception of a contractual relationship between the banker opening the credit and the seller of goods is inherent only in the irrevocable credit, for there is no obligation on the part of the opening banker under a revocable credit, which can be cancelled by him at any time, even without notice (see *Cape Asbestos Co. Ltd.* v. *Lloyds Bank Ltd.*, [1921] W.N. 274), and in which he merely invites the seller to draw on him but on the understanding that he (the banker) may withdraw the invitation without notice, right up to the moment the draft is pre-

* *Law of Bankers' Commercial Credits* (Sweet & Maxwell, 1932, p. 12).

sented for payment. The banker is under no obligation of any kind; under an irrevocable credit he is, for there is what Lord Sumner in *Sassoon* v. *International Banking Corporation* ([1927] A.C. 711, at p. 724) called a concluded contract, by which he meant a binding, though executory, contract.

In *Panoutsos* v. *Raymond Hadley* ([1917] 2 K.B. 473), an American bank opened a credit containing a denial of responsibility. It was held that the sellers were justified in refusing to deliver when the sales contract called for a confirmed credit.

CONSIDERATION AS AN ELEMENT IN CONTRACT

It is a feature of English law, which people from other countries sometimes find it hard to understand, that certain types of contract are not enforceable unless they are supported by what is known as *consideration*. It is a rule of law which requires that something of material value shall be given, or some detriment sustained, by the recipient of a promise in order that that promise may be enforceable. A promise to do a thing is not enforceable unless the promisor has received some *quid pro quo* or the promisee has undergone some forbearance amounting to a *quid pro quo*. This doctrine is peculiar to Anglo-American law and has been severely criticised in this country, and because of it it is hard to define some of the legal relationships which are set up by the issuing of a documentary credit. These relationships are basically all contractual, or they would be if it were not for the alleged disabling influence of the doctrine of consideration.

Moreover, it is a further rule of law that, for the promisee to have a right of action against the promisor, the consideration must flow from the promisee—in other words, the person seeking to enforce a promise must show that he (and not any stranger to the contract) has provided the *quid pro quo* or suffered the detriment.

CONTRACT BETWEEN ISSUING BANKER AND SELLER

As regards documentary credits, it is not at first sight easy to see just where the consideration between banker and benefi-

ciary lies. Yet there is no doubt that the English courts will give effect to the alleged contract between seller and banker. There have been strictures by foreign lawyers on what has been said to be the weakness in the English attitude to commercial problems, so far, at any rate, as concerns documentary credits. The fact is that notwithstanding that one of the essential constituents of contract may be missing, validity is given to a relationship which in law cannot exist apart from contract.

We may use as an illustration the case of the opening of an irrevocable credit at the instance of the buyer of goods. This, as I have indicated, consists of the banker's advice to the beneficiary that in given conditions (laid down by the banker's customer, the buyer and stipulated, presumably, by the seller) he, the banker, will meet drafts drawn upon him by the seller. There is no doubt that according to the law of all countries this obligation is binding, given compliance with the terms of the credit; it is binding in England even though the contract by virtue of which it is enforceable is said to lack that element —consideration—which in English law is necessary to support it, for on the face of it, it is argued, there is no *quid pro quo* flowing from the promisee, the beneficiary, to the promisor, the opening banker.

I need not burden you with the theories which have been put forward to explain this apparent weakness and in fact to show that it does not exist—the guarantee theory, the estoppel or trustee theory, the offer and acceptance theory. I will content myself by giving you that to which I myself incline, taken once more from Gutteridge: 'Therefore a buyer who, at the instance of the seller, procures the issue of a confirmed credit in favour of the seller, may be deemed to act as the seller's agent for this purpose, and there comes into existence a contract ancillary to the contract of sale by which the banker promises to pay the price to the seller in consideration of a promise by the seller to place him in possession of the documents of title to the goods.'* This is really the only theory which makes sense in English law as it is today. There is nothing to prevent one of two principals to a contract acting at the same time and for a specific purpose as the agent of the

* *Law of Bankers' Commercial Credits*, p. 24.

other; it happens—to choose a practical example—when a borrower from an English bank executes a charge by way of security in favour of the banker and at the same time appoints the banker his attorney for the purpose of enabling him if necessary to realise the property subject to the charge. However, if the recommendations published in the sixth interim (1937) report of the Committee on Law Reform are adopted, this difficulty will disappear.

Although the point has not called for decision in the English courts, there have been *dicta* which show quite clearly the trend of judicial thought on the matter. In *Donald Scott* v. *Barclays Bank* ([1923] 2 K.B. 1) Scrutton, L.J. seemed to assume (at p. 14) that there was privity of contract between the banker and the seller: 'The appellants gave a confirmed credit to the respondents; that is to say, they entered into contractual relations with them from which they could not withdraw except with the consent of the other party. . . .' Rowlatt, J. was even more definite in *Urquhart Lindsay* v. *Eastern Bank* ([1922] 1 K.B. 318), when he said (at p. 321) that consideration moved from the seller: 'There can be no doubt that upon the plaintiffs acting upon the undertaking contained in this letter of credit, consideration moved from the plaintiffs, which bound the defendants to the irrevocable character of the arrangement. . . .'

We can thus be satisfied that there is a subsisting and enforceable contract in English law the moment the issuing banker communicates to the beneficiary his promise to pay or, at least, when the beneficiary acts on the promise.

If there is any difficulty it is a theoretical rather than a legal one and it may be assumed that the courts of this country would not deny the existence of a binding contract except on grounds outside the situation described above. And it is not a practical difficulty, for banks everywhere regard the undertaking as binding.

BASIS FOR CREDIT TRANSACTION

The trouble arises in regard to the interpretation of the terms of the contract. To quote Gutteridge again: 'Much of

the difficulty in dealing with litigation arising in connection with bankers' credits is due to terminology and this difficulty is enhanced when one comes to deal with American case law on the topic. . . .'*

The contract of sale is the basis for the contract of finance by way of documentary credit. The terms of the contract of sale should, presumably, be clear to the buyer and the seller, and it is in transmitting such of them as are necessary to the credit that the trouble begins. This concerns the banker only in so far as he is required to carry out rigidly the instructions of the buyer, which form the basis of his (the banker's) contract with the seller. He is not responsible for the terminology of the instructions he receives; he has no other concern with the terms of the contract of sale. In *Urquhart Lindsay* v. *Eastern Bank* ([1922] 1 K.B. 318) at p. 323, Rowlatt, J. says: 'It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit.' The banker may advise on the drawing up of the mandate as the result of which the credit is issued; but once he has received it, it is his duty to communicate the terms to the seller and to implement them when the seller carries through his part of the ancillary contract which thus arises.

It was Gutteridge's view (p. 57) that 'it is impossible to standardise the nature and extent of the banker's duty with regard to documents tendered to him under a credit, because each case must be decided on its merits in the light of the phraseology of the letter of credit and the circumstances in which the credit has been established'; and, as a footnote: 'The English Courts have been very reluctant to deal with abstract points. They have invariably confined themselves with great wisdom to the relevant facts of each case.'

DOCUMENTS TO TALLY WITH CREDIT

Let it be said at once that it is the banker's duty and his right to insist on compliance by the seller with the terms on which payment is to be made. The banker cannot be com-

* *Ibid*, p. 15.

pelled to pay on any other conditions unless he receives the authority of the buyer for any variation. This was made amply clear a few years ago by an English decision which attracted much criticism in the United States of America, largely, I think, because the critics misunderstood the effects of the decision. I speak of the case of *Rayner* v. *Hambros Bank Ltd.* ([1943] 1 K.B. 37). In that case the defendant bank opened an irrevocable credit at the request of Danish buyers in favour of the plaintiffs, which called for full set on board bills of lading covering Coromandel ground nuts. When the documents were presented it was found that the bills of lading covered machined-shelled ground nut kernels, and the bank refused to accept them, declining to pay. It was argued for the plaintiffs that in the trade it was well-known that Coromandel ground nuts and machined-shelled ground nuts were one and the same thing; but, on the ground that a banker is not required to know the terms of any trade or commerce which he may be called upon to finance, the Court refused to accept that this was a valid argument. This decision has been criticised even in this country, for it has been said that another bank might well have paid in the same circumstances; from the other side of the Atlantic it has been sharply criticised in terms which include not only the courts but the attitude of English banks as well. It has been hailed, moreover, as an argument for unification. It seems to me, on the contrary, to be just the reverse.

The American criticism was based partly on the contention that it is no part of the function of a bill of lading to describe the goods in precisely the same terms as are used in the invoice and credit, and that so long as the general description tallies so as to identify the goods with those invoiced, nothing further is necessary. This point of view overlooks the fact that in English law, when a credit calls for documents describing the goods in a particular way, all the documents (except such as are obviously outside the category, viz., a weight note) must comply. This may or may not be necessary to commercial practice, but until traders call for a change and intimate that change in their instructions to the banker opening the credit, the law will be as it is and there is no point in criticising it.

When buyers are satisfied to accept documents of which certain ones only, but not all, tally with the instructions in the credit, then banking practice will conform to the new commercial practice. I do not accept the criticism that banking practice in this country does not conform to commercial practice (*ante,* p. 103). It is rarely that banks refuse to meet a demand of their customers, and where they do, it is generally for reasons which are sound viewed from the standpoint either of the banks or the customer. It is not any reluctance on the part of the Courts to follow commercial practice that accounts for the rigid requirement to which we refer above, but the fact that commercial practice today demands a more thorough reconciliation of documents and credit than is stipulated by our American critics. The true position can hardly be better stated than it was in an American case, *Laudisi v. American Exchange National Bank* (239 N.Y. 234), where it was said that 'the bank has the power and is subject to the limitations which are given and imposed by the customer's authority. If it keeps within the powers conferred it is protected in the payment of the draft. If it transgresses those limitations it pays at its peril.'

It seems to me that the banker must have great freedom of action, for otherwise it is impossible for him to be certain of doing the best for his customer and at the same time fulfil his obligation to the seller. It is quite impossible by any code to provide for every eventuality; and it seems impossible always to ensure the use by buyer and seller of terms which both parties understand to mean the same thing and that whatever terms are agreed upon are correctly stated in the instructions to open the credit. If the banker has to conform to a code, no matter how much that may relieve him of responsibility it is bound at times to make it hard for him to act in the best interests of all parties as if he is free to consider each case on its merits.

It is common knowledge that in times of falling markets, such as we are seeing again today, buyers have taken advantage of any technical defect to avoid their contractual liability; there have been circumstances in which a purely technical point has been pleaded in justification for instructing an opening banker not to pay, when goods of the precise type and quantity contracted for have actually arrived at their destina-

tion. Under a c.i.f. contract, for instance, a policy of insurance must be tendered even if the goods have arrived safely (*Orient Co.* v. *Brekke & Howlid* ([1913] 1 K.B. 531)). It is likely also that at times conformity with a code covering the point might avoid the seller's loss arising from technical equivocation, and that to this extent the real purpose of an irrevocable credit is not achieved. But, taking it by and large, the advantages of freedom of action in avoiding impediments which technicalities might involve may, over any length of time, be greater than the disadvantages arising from the somewhat dishonest shielding behind technicality in order to avoid a liability. After all, there is no reason why the same action should be taken by a banker in all cases of a similar nature; circumstances are never precisely the same and, even if they are, the parties are not.

The real import of the *Rayner* decision is that it permits a banker to be exacting; it does not say that he shall—he is free to take whatever line he likes in the particular conditions, if he is prepared to accept the risk. Any other decision would have lain far greater burdens on the banks and would have transferred to them responsibilities which are properly those of the trader.

It need hardly be said that a banker should take care not to get into a position in which he lends himself to any equivocation on the part of a buyer. In *Urquhart Lindsay* v. *Eastern Bank Ltd.* ([1922] 1 K.B. 318) a contract allowed for adjustment of the invoice price in the event of a rise in wages, etc., which in fact took place. The buyers tried to avoid payment and the bank, through acting on the instructions to cancel, attracted to itself the following comment by the learned Judge, Rowlatt, J., at p. 322: 'These instructions [not to pay] (very unfortunately, as I think, from many points of view) the defendants obeyed.'

The presentation of the documents must be made within the time laid down. In *Stein* v. *Hambro's Bank of Northern Commerce* ((1922) 10 Ll. L. Rep. 529), the Court of Appeal held that the wording in the credit: 'per steamer *Caboto,* leaving Calcutta about the middle of January', imported a condition and that as the loading did not take place until January 24

and the sailing until February 19, the bank was justified in refusing to accept the documents.

DOCUMENTS TO BE PRESENTED

English law is quite clear as to what documents are acceptable, within the general context that they must be those specified in the letter of credit. In *Equitable Trust Co. of New York* v. *Dawson Partners* ((1927) 27 Ll. L. Rep. 49), at p. 52, Lord Sumner said: 'There is not room for documents which are almost the same, or which will do just as well.' If any reason be required for the absolute right to reject documents which are not precisely those called for, it is to be found in the paramount duty of the banker to protect his customer's (the buyer's) interests, providing he does not break his undertaking to the seller. To quote Lord Sumner again, this time in *Hansson* v. *Hamel and Horley* ([1922] 2 A.C. 36), at p. 46: 'These documents have to be handled by banks; they have to be taken up or rejected promptly and without any opportunity for prolonged enquiry; they have to be such as can be re-tendered to sub-purchasers, and it is essential that they should so conform to the accustomed shipping documents as to be reasonably and readily fit to pass in commerce.' A banker is not called upon to resolve any ambiguity; if he is in any reasonable doubt he may refuse to pay.

In *National Bank of South Africa* v. *Banca Italiana di Scouto* ((1922) 10 Ll. L. Rep. 531) the latter were held justified in declining to pay against bills of lading, where delivery orders were called for, the bills being in such terms that they did not offer an unqualified right to delivery.

BILLS OF LADING

Taking the documents one by one, bills of lading must be clean (*National Bank of Egypt* v. *Hannevig's Bank* ((1919) 1 Ll. L. Rep. 69); and they must be 'on board' or 'shipped' unless the credit permits any others, for a 'received for shipment' bill of lading is not a good tender under an English c.i.f. contract for the sale of goods (*Diamond Alkali Export Cor-*

poration v. *Bourgeois* ([1921] 3 K.B. 443)). A delivery order is not sufficient. Again, the bill of lading must relate to just the goods covered by the credit and must be clearly referable to those goods, both as to description and shipping marks and as to quantity. The description of the goods in the bill of lading must tally with that called for by the credit, or, at any rate, such difference as there is may amount to nothing more than a difference arising from the use of non-technical language. In *London and Foreign Trading Corporation* v. *British and North European Bank* ((1921) 9 Ll. L. Rep. 116), Rowlatt, J. held that a bill of lading which did not specify the weight, but referred instead to the number of bags, of a shipment of meal, the credit calling for so many tons weight, was not acceptable. And the bill must cover the precise voyage and the whole voyage and by the named steamer if one is named. It was held in *Hansson* v. *Hamel and Horley* (*supra*) that an ocean bill of lading issued at Hamburg was not a good tender where the shipment began at Braatvag, Norway.

So far as English practice is concerned, bills of lading must not be stale, which generally means that at the time of payment they must be capable of delivery to the consignees before the goods themselves arrive. But there is no hard and fast rule. In the case of short voyages, for instance, it may be impossible to ensure that the bills of lading arrive before the goods. Where this is so, the banker will use his discretion and pay. Refusal to pay is based on the necessity for safeguarding the customer's interest to avoid the payment of demurrage, warehousing and other charges. It may, therefore, be considered an implied term of the contract between buyer and banker that except in the special circumstances outlined above, payment should not be made against stale bills of lading.

What is meant by a 'clean' bill of lading is hard to define with any precision. In general terms it may be described as one which contains no clause (which would ordinarily be overprinted) tending to indicate the carrier's doubt as to the good condition of the goods shipped—more technically, one which tends to derogate from their 'apparent good order and condition'. A clause, however, which covers the carrier against an eventuality which might well arise from the nature of the

cargo or its packing is not normally regarded as rendering the bill of lading dirty. Here there can be no universal rule, and so the contractual responsibility and thus the law must remain undefined; but it would seem worth while trying in this connection to achieve uniformity of interpretation, which must precede any substantial uniformity of action.

POLICY OF INSURANCE

Similarly, a policy of insurance, in the absence of authority to accept a certificate of insurance, means what it says and nothing less will do. Similar conditions apply as in the case of the bill of lading, viz., that the policy must cover the goods for the whole voyage contracted for, must relate only to the goods covered by the sales contract, and must be for an amount not less than the invoice price of the goods. Insurance certificates are not acceptable, perhaps not even if they embody the terms of the insurance contract. Much would depend upon the precise form of the document, but as a general rule a banker is not bound to accept anything less than a policy (*Diamond Alkali Export Corporation* v. *Bourgeois* ([1921] 3 K.B. 433; *Borthwick* v. *Bank of New Zealand* ((1900) 6 Com. Cas. 1)). Scrutton, L.J. took this view in *Donald Scott & Co.* v. *Barclays Bank* (*supra*), though he was not prepared to hold that all certificates of insurance were unacceptable. American law and practice are, it would seem, the reverse of the British (*Kunglig Jarnvagestyrelsen v. Dexter* ((1924) 299 F. 991)).

It is alleged that even in this country insurance certificates are becoming more and more acceptable to commerce. If this is so, it is not very definitely reflected in instructions for the issue of documentary credits.

Other documents may be called for besides the bill of lading, insurance policy and invoice—for instance, a certificate of origin, an invoice certified by a chamber of commerce, a consular certificate, a weight note and so on. All these must be referable to the credit and *inter se*.

When a draft is called for, it is a matter for consideration on the merits of the case whether a draft for a greater amount than that specified is acceptable. Here it is impossible to be

dogmatic; in *Donald Scott & Co.* v. *Barclays Bank* (*supra*), however, Scrutton, L.J. suggested that the tender of documents might not be invalidated, the banker being entitled to regard the excess as an authority to collect. This view should, however, be treated with some reserve, as those dealing with credits will readily understand, for it is submitted that the excess should be capable of reasonable explanation from the documents attached.

FORGED DOCUMENTS

A banker is not responsible for the genuineness of documents tendered to him under a credit (*Basse and Selve* v. *Bank of Australasia* (1904), 90 L.T. 618). He cannot be compelled to accept documents he knows to be forged and the tender of them coupled with a draft puts him under no obligation to accept or pay the draft. But payment in the belief that the documents are genuine entitles him to recoup from his customer or correspondent even if the documents are not genuine (*Ulster Bank* v. *Synnott* (1871), 5 Ir. Rep. 595). No action lies against a *bona fide* presenter of a draft with forged documents (*Guaranty Trust Co. of New York* v. *Hannay* ([1918] 2 K.B. 623)).

CONFIRMATION OF CREDIT

So far we have been discussing the simpler form of credit, to which the interested parties are the buyer, the seller, and the opening banker. Often, however, a fourth party is introduced, in cases where the opening bank is asked to notify the credit to the beneficiary through another banker who may be requested to add his confirmation; or where, the seller being in another country, it is convenient for the issuing banker to transact the business through its correspondent in that country. The relationship between the opening banker and the beneficiary in such a case may give place to two new contractual relationships—between the opening banker and his correspondent, and between the latter and the seller. These are all contractual, except where the intermediary bank is asked merely to notify and not to confirm, in which case he is the agent of the opening

intermediary correspondent is named, the seller relies on the banker and undertakes no responsibility himself. Where an correspondent if the latter adds his confirmation to the credit. But the correspondent may be asked merely to advise and not to confirm the credit—for a variety of reasons. It may be that the buyer wishes to avoid the commission payable for confirmation; or the opening banker may feel that his own undertaking should be sufficient and that his reputation would be impaired by the apparent necessity for confirmation.

It is here that there is some confusion of terms. A credit which is what Lord Sumner in *Sassoon* v. *International Banking Corporation* (*supra*) called a concluded contract is, I think, properly described as the irrevocable credit of the issuing banker; if the correspondent bank's undertaking is added, it becomes confirmed. In each case there is the irrevocable obligation of the bank—that of the confirming bank to the seller and that of the opening to the confirming bank. But the banks of the world do not agree on the same use of these terms, though there should be no confusion, for the term 'irrevocable' is capable of unambiguous interpretation; and if the term 'confirmed' is used in the sense in which it is used in Article 7 of the Uniform Customs, there should be no difficulty. The confusion may in part be due to statements in the courts such as that of Lord Sumner in *Sassoon's Case,* at p. 724, to the effect that there is really no difference from the legal point of view between a confirmed credit and an irrevocable credit. Both terms connote a concluded contract, which is what the learned Judge must have meant.

However that may be, under a confirmed irrevocable credit the seller will look to the confirming bank rather than the opening bank; in the great majority of cases it will obviously be simpler and more profitable for the seller, if he has to bring an action, to sue the confirming banker. Yet it is submitted that there may be cases in which a right of action would lie against the opening banker also, as where the opening banker is nevertheless the principal of the confirming banker. Once, however, the contract is established its nature and extent can be determined only by reference to its terms.

ASSIGNMENT OR TRANSFER

It may be useful at times for the benefit of a credit to be transferred or assigned. The latter clearly cannot be done without the consent of the buyer (see *Kemp* v. *Baerselman* ([1906] 2 K.B. 604)) and of the banker. In English law a contract which involves personal skill and confidence may not be assigned without the consent of the parties, for no one can be compelled against his wish to undertake a personal obligation to someone else. It was said in *Tolhurst* v. *Associated Portland Cement Manufacturers* ([1902] 2 K.B. 660) that assignment 'is confined to those cases where it can make no difference to the person on whom the obligation lies to which of two persons he is to discharge it'. The obligations inherent in a documentary credit may be essentially personal to the buyer of goods. For example, he relies largely, if not entirely, on the substance and honesty of the seller; it is the latter's responsibility to which he looks for due completion of his contract. While, however, the seller may perhaps assign only on express authority, there may be much to be said, as is argued in America, for using a form of credit which permits assignment, especially if it is remembered that the assignor does not rid himself of his responsibilities and liabilities.

Transfer is in a rather different category, for it usually means the substitution of one beneficiary for another. Sometimes transfer is necessary to avoid exchange control difficulties; in other cases it may be simply for the convenience of the seller, as where the seller is merely a buying agent for the manufacturers or producers; or again, to cover the gap between transit from the manufacturer at the factory to the seller at the port and from the port of shipment to the destination of the goods. With the consent of the buyer, the opening or confirming banker may permit the beneficiary to transfer, and it is usual, where he does so, for the banker to notify the ultimate beneficiary direct of the terms under which he will pay. There is no difficulty here.

But it may be, although this is today rare, that a credit constitutes an offer to all and sundry to accept and to ship goods in accordance with the terms of a contract of sale made with

buying agents. In these circumstances there is an ancillary contract between the opening or confirming banker and the buying agents which gives way to a further ancillary contract as soon as the buying agents pass the terms to the producer or manufacturer and the latter presents his documents and the bill for payment. The credit itself may be handed to the producer or manufacturer by the beneficiary.

However this may be, the relationships set up are usually capable of construction in terms of contract. When the buyer is aware that he is contracting with a buying agent (to him the seller) there is no difficulty in his instructing the bankers that the credit may be transferred; the alternative would be the clumsy one of having credits issued for every supplier, of whom the buying agent may not be aware at the time he enters into contract with the buyer.

ANTICIPATORY CREDIT

This last state of affairs leads naturally to the anticipatory (sometimes called 'packing') credit, which is designed to enable the seller (who, as indicated above, may be a buying agent) to finance his purchases by drawing on the opening or confirming banker before he (the buyer) actually ships the goods. Such a credit takes the ordinary form, except that it bears an additional clause commonly known as the 'red clause' or another known as the 'green clause'.

These clauses are customary in the Australasian trade, especially in regard to shipments of wool. The making of advances in this connection is discretionary and where it is done the bank is not responsible for the application of the moneys advanced. It is clear that where the opening and lending bank were one and the same, it would not lend in anticipation of shipment unless it was quite satisfied as to the substance of the importer, and the latter would authorise the advances only on being satisfied as to the substance and *bona fides* of the beneficiary or accreditee.

Where an anticipatory credit is opened by a bank which is not the bank making the advances—that is to say, where two

banks are concerned—neither bank accepts much responsibility. This is very clear from the wording of the opening instructions. The lending banker is granted a wide degree of discretion which frees him, generally, from all responsibility—though sometimes the banker is authorised to lend only against warehouse receipts. In other words, the responsibility lies with the importer, who must have such knowledge of the exporter that he is satisfied to authorise advances to be made in anticipation of shipment. If these advances are not repaid then the importer is liable.

The 'green clause' contains the further undertaking to hold the opening bank covered in the event of the bank's finding it necessary to store the goods before shipment and an authority to the banker to release the store warrants against an undertaking to deliver shipping documents in due course. Moreover, the benefit of the insurance of the goods while in store is assigned to the opening bank. The opening instructions for a 'green clause' credit, therefore, embody a letter of trust.

NEGOTIATION CREDIT

The credits we have been dealing with up to this point are those by which the issuing or confirming banker undertakes to pay against documents—either a bill of exchange drawn on the banker or, perhaps, in the case of a correspondent banker, to the debit of the issuing banker's account. But a credit may provide for drafts on the buyer, the seller being informed that any bank (or a specified bank) is authorised to negotiate the drafts, i.e., purchase them—in which circumstances the opening banker undertakes to hold the negotiating bank covered. Here again the contractual relationships are quite clear, though there is one point of doubt—whether the negotiating banker has a right of recourse to the drawer in the event of the bills being dishonoured (in cases where the drawer does not sign 'without recourse') for it is argued that if there were such recourse the whole purpose of the credit would be lost (see in this connection *Sassoon* v. *International Banking Corporation* ([1927] A.C. 711), in which the point was argued and then abandoned).

Gutteridge expresses the view (p. 50) that there is no foundation for this argument. 'No doubt the purchaser of the draft places his chief reliance on the credit of the banker, but this will not of itself suffice to release the seller. If the seller desires to escape liability he can always sign "without recourse"; and if he fails to do so he must be taken to have accepted the usual liabilities of a drawer of a bill of exchange.' And he quotes Lord Sumner in *The Prinz Adalbert* ([1917] A.C. 586), at p. 589 in support.

It seems to me, with respect, however, that the matter may depend on the circumstances, on the terms of the banker's contract with the seller. If the credit is an irrevocable undertaking to negotiate, then the position would seem rather different. Would there not be an implication that there would be no recourse to the drawer? Where a bill is in the hands of a holder in due course—as where it has been 'negotiated' by a bank other than the one opening, confirming or advising the credit; or where it has been negotiated by someone other than a bank—there can be no doubt that unless the drawer signs 'without recourse' he is liable to such a holder in the event of the dishonour of the draft. It is improbable that a negotiating banker would negotiate further, but where it did the transferee would presumably be a holder in due course, with a right of recourse. Between the drawer, however, and the bank giving an irrevocable undertaking to negotiate, there might, I submit, be an implied term of the credit contract which overrides the contract embodied in the bill of exchange.

It is submitted that as between the seller and a paying (as opposed to a negotiating) bank, it is an implied term that if payment has been made the money can only be recovered back if it transpires that the documents were forged or unacceptable for some reason inherent in the documents. Recourse would be unavailable if, for example, the credit, though stated to be irrevocable, was in fact cancelled, perhaps by operation of law or legal process, before the buyer's account was debited. In other words, if the seller had carried out all the terms of his contract, he would be entitled to rely on the absoluteness of an irrevocable credit under which he had been *paid*. But if the seller had *negotiated* his draft the negotiating banker would

not be entitled to recourse (assuming that the drawer had not immunised himself by drawing 'without recourse') if the banker by the terms of his irrevocable undertaking, expressed or implied, had agreed that there should be no recourse, as would, I think, be the case where the bill was negotiated by the bank opening or confirming the credit.

UNIFICATION

In order to understand the difficulties in the way of unification of procedure in regard to documentary credits, it is only necessary to see for a short while the work of the documentary credit department of a bank. The main, and strong, argument against unification is the necessity for treating each case on its merits. The Committee on Banking Practice and Technique of the International Chamber of Commerce in November last considered the Uniform Customs and published a report by Monsieur Jean Gurtler in which it is said, in reference to the attitude of Great Britain bankers, that 'local traditions and laws appear to be the cause of this failure' to agree upon uniform regulations. What this means I am not sure. It is my conception of the matter that documentary credit work is of all banking transactions the least capable of unification; that not only may safety depend on great freedom of action, but the best service also. As I have said earlier, not only are the same circumstances rarely repeated in entirety, but the parties —buyers, sellers, opening and corresponding bankers, are individuals with their own outlook on the particular transactions into which they enter. In doubtful cases, if the banker is able to obtain instructions from the buyer, well and good; if not, he takes the risk of offending either his principal, the buyer, or the beneficiary, the seller. No law will help him here, for the law has not been interpreted by the courts and cannot be until the case comes before them. Yet a good documentary credit man in a bank becomes very knowledgeable and astute, and construing instructions in relation to documents becomes a matter in which the flair of the banker is most likely to bring the proper result and may largely offset lack of agreement in this respect.

But it is no part of my task this morning to deal with the practical implications of unification. It may in some measure be true that local laws are responsible for failure to agree, but only if by laws is meant custom. There is nothing in the English law of contract to prevent unification. But a contract, i.e., the intentions of the parties entering into it, may have to be construed by reference not only to the express terms of the contract, but also to implied terms drawn from the circumstances in which the contract is made. If the English banks agreed to comply with the Uniform Customs they would be inserting terms into their contracts with their customers and with sellers for which these latter would have to contract out if they did not accept them. I see no difficulty here. The perhaps not very serious weakness lies in the fact that if the Uniform Customs became the customary behaviour of the banks in this country, they might depart from them at their risk. Even if departure were not regarded in this disabling light, it might be that any breach of the rules would be construed as evidence of a falling-away from a duty or obligation, as has at times failure to follow the directions laid down in a book of instructions by the head office of a bank. Departure from a settled course of action, in circumstances in which one party to a contract is entitled by usage to assume that that course of action will be followed, may amount to a dereliction of duty or to negligence.

Therefore I am inclined to approach the question rather warily. But while unification of practice in the sense of unification of functioning may not be as desirable or as easy of achievement as it is alleged to be, nothing but good can come of further enquiry. The matter ought not to be treated as if it were a question of complete unification or no unification. It is not a case of all or nothing. There are several facets, each of which deserves consideration of its own. For instance, it seems to me that unification of terms, of phraseology, has much to recommend it; and with substantial agreement on terms would come substantial assimilation of practice, perhaps without the cramping influence of a code. It may be of more importance that all banks should know what is meant by the term 'insurance policy' than that they should agree to accept an insurance certificate in lieu thereof. By all means let there be consulta-

tion between banks *inter se* and between banks and the commercial and trading communities.

Yet the practice must first be set up by the trader, not the banker, and it will be found that banking and the law will adjust themselves—easily, as I think—to the changing requirements of practice, for the simple reason that it is the function of the banker to serve his customer, and of the law to give effect to the intentions of the parties as evidence of their written contract and their customary behaviour. While any attempt by the banks to force a code on to the trader may savour of a retrogressive effort to avoid the risks inherent in the successful transaction of export business, there is every reason for trying to reach common ground in the general interest of world trade.

British Export Policy and Practice

By

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When I was a young man—more years ago than I care to remember—I lived in an England which, many people say, has disappeared for ever. Some of you will remember that England, with Edward the Peacemaker on the throne; many of you only know of it by hearsay, or incompletely as children. In many respects it was a wonderful England: almighty in wealth, all-powerful in commerce and in her international relations, and all-oblivious of what the next forty years had in store for her. Never did I, as a young man, hear anyone use the phrase 'Export Policy', for the simple reason that there wasn't one and for the more cogent reason that there was no apparent need for one.

I suppose it must seem to many of you that the England which has lived by her exports ever since the nineteenth century must always have had an export policy and that all her population must have been as acutely conscious of it as we are today.

In point of history the very reverse is true. Although we seem to have lived through a whole lifetime of export crises the fact is that we, as a nation, have only become conscious of the need for an export policy since the last war. Therein, I may say, lies the tragedy of our present plight. To us living in an England of austerity, unbalanced trade and 'gaps' of various kinds, it seems incredible that our export machinery should not have been brought to a pitch of shining perfection through all the years we have depended on it for our very existence. After the last war, when Britain first realised that

exports were really a life-and-death matter, she looked with astonishment and dismay on the rusty Victorian four-wheeled cab on which she was expected to drive to success and prosperity in her overseas markets. What was this, she said, why had this to be brought out of the Victoria and Albert Museum to take her on her long and perilous journey? Why, indeed!

Let me—as a business man with no qualifications to talk to you other than a very full business life—let me tell you how I think we got into this mess and how I think we can get out of it. What I have to tell you is not new. Quite frankly, I have said it all before. But amid all the nonsense which is being talked on our political platforms, which we could do without, and amid all the theorising of our financial pundits and economic experts, much of which is of the greatest value, there is need—urgent need—to introduce a note of realism. This is what I shall endeavour to do in my remarks to you.

Let us return, then, to our four-wheeler and ponder for a while on the reasons which led up to our ownership of such an antiquity when many of our contemporaries are running about in streamlined 1949 automobiles.

I. THE BIRTH OF AN EXPORT POLICY

(a) *Exporting for fun*

For the beginning of the story we must go back quite a long time in history—to the first great industrial period of England during the reign of the Tudors. The population of the country at that time was, surprisingly, only five million people, who fed and clothed themselves sufficiently well from the produce of the land. There was then no real need, as we know it, for an export policy. Indeed, there was little need for exports. But such was the astonishing vigour and adventurous spirit of the people, fostered by a government which fully supported private enterprise, that we find men like Drake, Frobisher, Hawkins and Raleigh, who, for the sheer joy of adventurous living, sailed the wide world and opened up to their countrymen at home new realms for trade, and who unwittingly prepared the way for British export trade as we know it. It would have been interesting, and probably instructive, to have asked

Drake to discuss his export policy, or to have heard Raleigh's comments on his being informed of the Ground Nuts Scheme.

So the picture of this period is of Merry England needing no exports, much less a policy, but exporting just for the fun of it. As a sideline—quite a profitable one from all accounts—she indulged in a little 'black market' in the literal sense of the words by the capture and sale of negro natives as slaves.

(*b*) *Exports needed, but policy not essential*

Two hundred years later came the second great industrial period and a more sombre colour comes over the picture. No longer is the scene one of an England quite so happy at her work. The Industrial Revolution introduced strident notes which swelled in volume down the years to become the industrial discordance of the present century. The Industrial Revolution changed the entire pattern of British life, and while it made Britain far and away the most powerful and incidentally the most envied nation in the world, it brought in its train a tremendous increase in population crowding into the towns from the countryside, needing food which far outstripped home resources, and it created such an enormous demand for raw materials to turn into finished articles that exports to pay for the food and raw materials changed from an adventurous game to a real necessity. The necessity was not realised, however, for there was no difficulty at all in providing the goods for export and even less in selling them overseas. England had so far outstripped the rest of the world in her industrial development that she could produce goods of the highest quality at prices which were unbeatable. Moreover, the oceans of the world were her highways. Four-fifths of the world's steamships were British. In fact, it can be truly said that all the strings of world trade were in British hands and she manipulated them according to her will.

It is perhaps worth noting in passing that the adventurous factor in the British character had by no means passed away with the Tudors. In the new age it displayed itself in the initiative of the enterprising individual who thereby reaped a share of the benefits of this astonishing period.

The prosperity of Britain now arose from the unfettered enterprise and industrial adventure of a comparatively large number of individuals, whereas the success of the Tudor period relied chiefly on the outstandingly adventurous spirit of the few.

Our picture of this period, then, is one of an England sowing the seeds of her future greatness and of her possible future decline; of an England requiring an export trade and creating without difficulty a virtual monopoly in this respect; of an England swiftly becoming wealthy, majestic, powerful, but without any real idea how it all happened and without an export policy worth the name; and of a Victorian England rather pompously driving her way somewhat ruthlessly through her export markets to the sycophantic applause of the world.

(*c*) *Exports and policy both needed*

Then came the first world war and with it was ushered in the next important period in Britain's industrial history, a period pregnant with the seeds of success or failure.

The old economic system was shattered to an extent which went far deeper than was appreciated at the time. For a hundred years England had basked in the sunshine of her *Pax Britannica,* and after the war she still continued to bask, too unmindful of the clouds which had appeared over the horizon. A large part of her shipping had been sunk during the war and was not replaced soon enough to prevent serious encroachment by other nations on this preserve. The war had stimulated industry overseas, particularly in the United States, which had travelled far on the way to industrial supremacy. Other nations, too, had penetrated our overseas markets and those markets themselves had, during the war, jumped at the opportunity of creating their own industries.

So for the first time Britain, who now needed her export trade more than ever, found that she had serious competition and that her exports had begun to decline.

One would have thought that this would have been the time for British industry to have paused and taken thought: to have asked itself whether it was prepared and properly equipped for an export trade war. But, with a few exceptions

here and there, British manufacturers were inclined, like the ostrich, to hide their heads in the sands, a course of action which unfortunately leaves a portion of the anatomy very open to attack!

The crying need was for more exports—there were less: for an export policy—there was none.

The picture now is of our old four-wheeler, long past its prime, panting furiously uphill. Round the corner at the bottom of the hill are appearing several streamlined shapes rapidly gaining on the old crock. One or two of the passengers hesitatingly suggest to the driver that perhaps it would be advisable to stop at the next garage and swap the old cab for a modern car, but they are laughed to scorn, and with the driver's comment that what was good enough for his father was good enough for him, they continue merrily on their way unheedful of the encroaching danger behind.

(*d*) *Exports desperate and policy born*

Finally, in our potted historical survey, we come to the fourth, the present and perhaps most vital of Britain's industrial periods. There is little need for me to elaborate the difficult circumstances in which we find ourselves after the last war. We know them all too well. If the need for exports in the inter-war period was real, it is now desperate. The nation realises the problem at last, but at the last moment. At last we are fighting tooth and nail for exports and at last we have an export policy. Whether we are being successful in the fight and whether the policy is the right one are matters for conjecture and opinion. The tragedy is that the policy is still so new and was presented to the nation so suddenly that there is still a great deal of ignorance on the subject, the symptoms of which are evident in the unofficial strikes and the industrial unrest which so sadly disrupt our unity at a time when unity is so essential. And yet you must agree that the results we have achieved so far have been remarkable.

Our picture now is of the old Victorian cab being ruthlessly scrapped and of a frenzied rush to design and build a new racing model. Like all new models, it is having its teething

troubles, and there is much heated argument among the planners, the passengers and the driver about the way to put them right.

II. BRITAIN'S EXPORT POLICY

Considering that the period of gestation of our export policy has taken about four hundred years, one would expect the child to be something really out of the ordinary. Contrary to our expectations, we find that the fundamental policy is quite simple and is, broadly, to export everything everywhere even if it means starving the home market: even, it seems, if it means starving. Closer examination shows, however, that our finding is qualified by three important considerations:

(1) As most exports involve imports of raw materials, the policy is to export those products having a high labour content.
(2) As much of our food and raw material, together with a considerable volume of special machinery, has to be purchased from North America, efforts have to be made to direct our exports *to* North America.
(3) As our immediate financial resources are so slender, we have to export as far as possible for prompt cash or on short credit. In other words, our export policy is largely controlled by the Treasury, and as a result tends to be a short-term one, ignoring the long-term need of maintaining our connections with what will be our markets in the future. I would ask you to conjure up the picture of a big business being directed by its cashier.

It is easy to understand that such a policy begs many questions and leaves many others unanswered. It assumes—and what a colossal assumption this is—that we have and shall continue to have the means to purchase the necessary raw materials and that all other countries, or at least all those to whom we wish to export, will have and will continue to have the wherewithal to pay.

In other words, it assumes that the world will return to multilateral trading and will return to it soon. Before this

assumption can possibly become a reality there are many apparently insurmountable difficulties to be overcome. But overcome they must be if world economic chaos is to be avoided.

The first and biggest problem is to increase trade between the sterling and dollar areas to the point where the dollar gap is closed, and then to straighten out the tangled trading web between the sterling countries themselves. How simple it is to say that, and what untold headaches it will cause and what setbacks, prejudices and political considerations will have to be overcome before the dream is achieved!

Let us consider the sterling-dollar situation. First, it should be appreciated that in 1948 European production surpassed the 1938 level by 13 per cent. Productivity rose in the year itself by 9 per cent and the volume of exports by 30 per cent. That is, I suggest, a remarkable achievement, and is evidence of the success gained by the *Marshall* plan towards the restoration of European production. But production in itself is not enough. The flow of trade and its direction are equally important, and here the position is far from satisfactory. While in 1948 the sterling countries went some way towards balancing their accounts with the United States, the out-of-balance still amounted to 2,300 million dollars. As the United States and Canada supply nearly half of the world's exports of foodstuffs, a figure which is not likely to be reduced materially for many years to come, and as the supply of raw material from the same countries cannot be obtained in the required quantity from other sources, it seems certain that the sterling countries will be in the red with North America far beyond the end of *Marshall* aid in 1952.

This all boils down to the fact that the sterling area, and this of course includes Britain and the British Commonwealth of Nations, must buy from North America and North America must buy from the sterling area. I do not believe that Britain can close her own dollar gap by bilateral trading with North America. We are attempting to do this, but I believe the most we can hope for by this means is only a reduction of the gap. The real solution of Britain's problem is the same as

for all other individual countries in the sterling area—the solution achieved by multilateral trading. Such a solution can be made effective only by the United States. It is important to realise that there are only three ways in which the sterling countries can close the dollar gap—by expanding sterling exports to North America, by continuing to borrow, or by curtailing imports. The curtailing of imports is the only choice which the sterling area is free to make, and it is a most unprogressive and restrictive choice. The other two ways are entirely in America's hands: she can either open up her markets, by reducing tariffs, to sterling products, or she can continue to lend money—or better still invest it in the sterling area.

May I put it a little stronger, the moral of recent events—grim as they are—is that the time has come for the United States to tackle the dollar problem from her side of the fence. She must have an export policy. She must allow sterling countries access to American markets on the same terms as the main bulk of American products are given access to the markets of sterling countries. Until America has put her own house in order she will find other countries not only unwilling to adopt multilateral trade—she will find them unable to do so. The Anglo-Argentine meat agreement, of which America complained so bitterly, is a good instance of the bilateral agreements sterling nations are being forced into because the United States authorities have so far refused to see that these agreements and the processes by which they are reached are in reality the result of American failure to face up to the problem of their export surplus. A surplus which America is bound to produce but doesn't need and which she wants to sell to a world that needs them urgently but can't buy, is too fantastic a situation surely even for the most obtuse of our western world's statesmen to leave unsolved. The proper reaction to the crises which will inevitably recur in the sterling area is not to seek a short-cut to isolated economic salvation by introducing restrictive practices, but for the sterling area to work out together with America a realistic and permanent way of overcoming their economic differences. This is one aspect of the export policy which Britain should strongly support. (It

would apear that this is happening in Washington today.)

In the meantime—and until such agreement with America is reached—we have to put up with bilateral agreements with one country after another. Such a policy is as unsatisfactory as it is unfortunately necessary. One of the more unsatisfactory features is that, while there is an exchange between the two parties of goods they require, each has to take a number of things it does not require but which the other party wants to sell. There naturally exists a limit to the amount of bilateralism which a country can support. It is easy to see that most countries would want the same kind of goods from Britain in exchange for food or raw materials, and it is as easy to see that Britain would not have enough to go round. The general dissatisfaction so caused supports the tendency to introduce restrictive practices such as import licences, or even complete import bans, on those goods Britain wants to sell, and these restrictions in turn create trade unbalances in other quarters, causing more licences and bans to be enforced! In this way the vicious circle is completed, and the non-dollar countries would soon find themselves thinking along similar lines to the British housewife in the war, who nostalgically remarked: 'If we had some bacon it would be nice to have bacon and eggs, if we only had some eggs.'

While the policy of bilateral agreements saves dollars and keeps Britain and Western Europe on their feet, there is an important political aspect of it which must not be overlooked. Bilateral agreements inexorably widen the gap between us and North America. Indeed, if the policy of bilateral agreements were driven to its logical conclusion, trade with North America would dwindle to a trickle. While this would certainly 'balance the books', it would be a measureless calamity for three very important reasons. First, it would deliberately cut off western Europe from the greatest source of wealth in existence and would involve western Europe in a degree of poverty it has never before experiencd. Secondly, America's surplus production which she could not export would create slumps worse than she has ever known. Thirdly, western Europe, unable to be dependent on her friend and ally America during her years of need, would certainly be driven to dependence on less

friendly and undependable nations for the bulk supplies of grain and staple food of which they would be the only available source. It is, I suggest, inconceivable that increasing economic division, tantamount to economic war, should be allowed to develop on the one hand while, on the other, the political and military integration of America and Europe, on which the survival of both depends, draws them closer together.

How does British export policy navigate this broad river of treacherous currents? The honest answer is that no country, with the possible exception of the United States, can have a working export policy until restrictive practices by the nations are halted and multilateral trade established. Until that happens any country's 'export policy' at the present time could be more truthfully called an 'export pious hope'. What else when, for example, it must be confessed that Britain's export drive is weakening, not in effort but in result, and that we may well be beginning a new phase when production may become an embarrassment because of our inability to dispose of the product. It would be hard to conceive of an export policy without exports.

We therefore come back again to the one real solution to the problem, a solution which rests entirely with the United States; a solution which they *must* provide if our great civilisation, which we share as a common inheritance, is to be perpetuated. America *must* open her markets freely to the sterling countries. She *must* pull down her tariff walls. In this respect, I was very glad to see President Truman's most important statement which he made in his mid-year economic report. He said: 'The decline in United States business activity is reducing imports, and this is an important factor affecting the ability of foreign countries to earn the dollars required to restore their economic health. Such a decline in imports, if long continued, could have very serious effects. If there were a severe shrinkage in the flow of dollars abroad it would not only reduce United States exports now but would also force other countries to try to save dollars by making discriminatory trading arrangements which would adversely affect the long-term future of the foreign trade of the United States.'[1]

The President's more recent statements show how clearly

he realises the position—but will the people of the United States realise it, also?

III. A NEW EXPORT DIPLOMACY REQUIRED

Now in my view our export policy, in common with those of other countries, shows insufficient imagination. It is restrictive rather than expansive in practice, and is still based too much on old-world ideas and economy. It does not take into account the new circumstances which arose in the inter-war years and which have thrived on the shattered world economy resulting from the last war. It should be reshaped and extended in those directions not only where it impinges on our own effort but particularly where it enters the field of world economic diplomacy. For until world conditions become stabilised an export policy must be more diplomatic than executive; more persuasive than formulative.

Healthy conditions for overseas trade are of vital importance to a world economy threatened with collapse and the world is looking to Britain and America for inspired leadership. We are all paying too much lip-service to expansion in trade and at the same time we indulge in precisely those restrictive practices which prevent it. For example, the United Kingdom plans to increase its exports in the fateful year 1952-3 to 150 per cent in volume of its 1938 figure, whereas its imports are expected to remain considerably *less* than prewar. Since other nations, with an eye on the example set by Britain, their biggest customer, are also urging expansion of exports and restriction of imports, and since the imports of one nation are the exports of another, it is difficult to understand how under the present system international trade can ever attain even its prewar level.

Is not every nation thinking too much of exports and too little of imports? All sellers and few buyers will never get world trade going again. We need import policies as well as export policies. Putting it another way, are we not all, both nations and individuals, just pursuing our own selfish way? Is it too much to hope that we can introduce into our policies, both personal and national, the ideals for which Christianity stands? A code of international conduct so based would not

only be far better than the complicated charter of U.N.O.—it would go far to eliminate the chance of war and the fear of war, which have been two of the main causes of the dis-equilibrium in international trade.

I am trying to suggest to you that many of our problems, both national and international, are psychological, and it is useless to think of solving them by objective methods. For example, the manufacturer in the U.S.A. has got to be persuaded that it is for the good of the world, *and therefore for his good* (that's the crux) that he should buy his raw materials from other countries, rather than go to immense expenditure to secure for himself independent supplies in the U.S.A.: he should be also made to realise that he should pay a reasonable price for the materials he buys, such as rubber, instead of beating it down, as he does today, to a figure almost below prewar, and at the same time that he should charge the cheapest possile price for what the sterling area has to buy from him. Likewise, the American consumer has to learn that it is for the good of the world, *and therefore for his own good,* that he should buy goods made in the sterling area, even at a slightly higher price. If we all look at our own countries, we can find ways in which we might abandon a selfish policy and make a contribution to world prosperity.

Now here you must forgive me if I offer a word of advice to you gentlemen of the banking fraternity! I would beg you not to look upon the figures in your customers' accounts just as merely debits and credits, expenditure and receipts, or purchases and sales. Rather would I like you to regard them as reflections of the likes and dislikes, whims, idiosyncrasies, passions, hates and fears of the consumers, and the imagination, efficiency and drive of the manufacturers. If we view international accounts in this way, you may agree with me that much may be done by paying more attention to the psychological factor. I make no apologies for this apparent digression from my main theme—believe me, the success of any export policy depends mainly upon the correct solution of psychological problems.

Now to return—the system which worked so well in the nineteenth century was our system and there is little hope, in the

totally changed conditions of the twentieth century, that this same system can be made to work today. The new world creditor is not likely, within a period which matters, to import as much as she exports and whether she will continue indefinitely to lend money or give it away, as she has so generously done in the last few years, is extremely problematical.

We must therefore recognise this fact and make those changes the situation demands. In this connection I would like to refer you to the Memorandum on a System of Multilateral Contra Account submitted by the London Chamber of Commerce and approved by the Sixteenth Congress of the Federation of Chambers of Commerce of the British Empire in September 1948. I have had this memorandum copied as an Appendix to this talk, and I am indebted to the Birmingham Chamber of Commerce Journal (March 1949) from which it was extracted and on which I have based my comments.

The essence of the scheme is that a nation would acquire credits when it exported. It could only clear those credits when it imported, so creating a contra account. It need not necessarily import from the country to which it sold, but if it wished to take payment, it could do so by importing *from* the world to the value of its exports (visible and invisible) *to* the world.

The important point in these proposals is that credits so created and not cleared by imports would be cancelled after an agreed term.

It is obvious, of course, that this particular system could not be put into operation without considerable investigation at government level by all the nations concerned, but as we now live in a new world we must consider in a tolerant atmosphere any new proposal which may contain even only the germ of the solution to our difficulties. The root fear of the nations at the present time is of an adverse balance of payments, and this fear can only be removed by a trade system which will encourage willing sellers to become willing buyers. A system of trading which removes this fear and paves the way to harmonious trading among the nations to their mutual advantage is worthy of the deepest and most urgent thought and consideration. Unless some such scheme, appropriate to mid-

twentieth-century conditions, is devised and operated without undue delay we can give up all hope of expansion or even maintaining the progress we have made so far since the war. Should world trade become strangled and expire, the political consequences may be too dreadful to contemplate.

It must therefore be Britain's duty, as leader of the Sterling Area and as part of her export policy, to press this matter with urgency and with statesmanship.

IV. BRITAIN'S EXPORT POLICY AT HOME

What success we have had in pushing production to its present level has been by the efforts and patriotism of a large section of the population.

Let us consider how our export policy at home is enforced and how it affects our production.

First of all, there are export targets set by the government. These are good psychologically for a time at least. I believe that after a time they lose their value because the triumph of attaining a target wears off as new ones are regularly presented. Moreover, the target figures set are at best good guesses and at worst very bad guesses. Sometimes they are too high and sometimes too low. If they are too high, the workers and management become disheartened by elusive achievement, and, if they are too low, the workers become self-satisfied by a too-easy triumph. Whether targets should be continued is problematical; on the whole the balance is probably in their favour.

A very much more contentious part of the home export policy is the control of raw materials by the government whereby it is laid down for a whole industry, or for an individual firm, the percentage of its output to be exported, under the threat of withholding raw materials. There are many serious disadvantages of this system. One of the first evils that became apparent was the large number of mushroom firms, maintaining no British traditions of quality, which poured their cheap and ill-made goods abroad to the detriment of British prestige. Such firms have ceased to exist, but damage has been done which will take time to repair.

Again, insistence on the exporting of a definite percentage

of production forces many factories into the anomalous situation of having to curtail production and consequently to increase prices. This at a time when the cry is for more production at reduced prices is surely an unlooked-for result by the architects of the scheme. The factories of most exporting firms are laid out to meet both home and export demands and any curtailment of the one immediately affects the other adversely.

Then there are those unfortunate firms who must produce utility and non-utility types of the same product. It is agreed that utility production did at one time safeguard the minimum standards of quality; but it certainly does not produce those improvements in design, quality and novelty which are essential if our exports are to be maintained to nations able to produce their own everyday requirements. The vitally important textile and furnishing industries have to put up with many serious difficulties of this kind. It is my belief that the present system of permitting manufacturers to dispose of only a small percentage of their non-utility production in the home market is definitely harmful to our export trade. It is, in most industries, difficult and costly to produce two different types of product in the same factory, one for the home trade and the other of better quality for export. The time has come when, with increased competition, legislation to enforce standards of quality can be dispensed with and non-utility goods should be provided for the home market so that the one type of product can be produced more cheaply in the factory.

Next, there is the all-important question of bulk purchasing by government trading. You will never convince a business man that a commission of government officials can be regarded as the most economical means of obtaining our vital supplies of raw materials, even though the need for some measure of direction of policy and exchange control undoubtedly remains.

V. AIDS TO EXPORT

I have said as much as I can, in the time allowed, of the attitude or policy we should adopt in the sphere of exports. Before I finish this talk I must refer to a most important aspect of our export technique. The premise on which any export

policy must be founded is that we have the right goods to sell at the right price. I believe we now have the best goods in the world to sell, but I think the price is dangerously high. Our aim must be to get the consumer in the frame of mind that if he wants the best he will be safe if he buys British. But while he will expect to pay a little more, we do not want him to gain the impression that he is paying through the nose. Let us ask a higher price, certainly, for real quality, but let it be a reasonable price. Now we are taking steps to ensure that the appearance of the goods reflects the high quality within them; that they are packed properly in packaging and wrappings suitable for the particular part of the world for which they are intended. Most important, perhaps, of all, we are now conducting adequate market research before we try to sell refrigerators to Eskimos or electric irons to the naked tribes of Africa. And finally, we are making certain that our beautiful product of high quality, securely packed in an attractive container for despatch to a customer who wants it above all others, is not held up *en route* because the despatch clerk doesn't know his job.

How are we ensuring all these essential requirements? By a system of education which has been going on for some time and which is now bearing fruit. To assist industry on those important matters a number of bodies have been formed which together present to British industry a source of knowledge and experience of which any country—including the U.S.A.—would well be proud. Their effect is already being felt—British goods, today as always of the highest quality, are improving in appearance and presentation, and our export staffs are second to none. These organisations are:

The Council of Industrial Design.
The British Export Trade Research Organisation.
The Institute of Export.
The Institute of Packaging.
The Travel Association.
The British Council.

The function of the Council of Industrial Design is to promote by all practical means improvement of design in the

products of British industry. The word 'design' covers the many processes in the planning of goods for production, and includes structure, texture, form and decoration. It is open to any manufacturer to ask for the Council's advice, and many have taken advantage of it.

The British Export Trade Research Organisation, or BETRO as it is usually known, undertakes some of the most vitally important work in connection with our export drive. BETRO was created to provide a comprehensive service of scientific research and intelligence on markets for British products throughout the world. It specialises in consumer and dealer research, using modern scientific methods. It is non-profitmaking and its services are available to all British manufacturers.

The Institute of Export fills the need in the national interest for an organisation dealing with the education and training of the personnel for export. It is the Institute's aim that every exporting firm should have on its staff members fully qualified in export technique.

Then there is the Institute of Packaging, a more recent organisation, whose main purpose in life is to promote the use of the right packing and packaging for British goods. The study is encouraged of the most efficient methods using those materials which are available in this country.

I would like to mention two more aids to export which, although they do not affect the manufacturer directly have a most important bearing on our overseas trade. I refer to the British Council and the Travel Association.

The British Council was formed to promote better understanding and to lay the foundations of lasting friendship, between Great Britain and all other nations, by interpreting to them our country and our people, our ideas, traditions, institutions and achievements. It has done and is doing invaluable work in this respect. I am sure you will agree that anything that can be done to persuade our foreign friends that we are not as mad or even as bad as we appear to be, is all to the good.

The good will accruing from the work of the British Council is carried a stage further by the Travel Agency whose main

purpose, not sufficiently recognised in this country, is to publicise the tourist attraction of these islands throughout the world. We in this country fully realise how valuable this tourist trade is and how important it is that everything possible should be done to make our visitors happy and comfortable while they are with us. I hope those of you who have come from overseas feel that you are really welcome here, as indeed you are. The important part is that the visitor should feel that he is welcome, and this often depends upon first impressions. Our docks and airports may not be things of beauty, but what I think you will remember most is the cheerful smile and the willing service of the porters who look after your luggage. That's British, that is!

VI. SUMMARY AND CONCLUSION

In conclusion, may I be allowed to sum up. I have endeavoured to show that our export policy, such as it is, was introduced for the first time to a bewildered nation after the last war, whereas it should have been formulated in the inter-war years when the writing was on the wall for those with eyes to see. It was produced too hurriedly and too late to prevent its impact causing unrest, misunderstanding and even disbelief. In concept it is unimaginative: restrictive rather than expansive. I have tried to indicate how it should be extended to embrace a world diplomacy in so far as its external contacts are concerned, and how it should be radically changed on the home front to encourage rather than frustrate industry. I have emphasised the urgent need for some system of multilateral trading between the nations and a method by which it might be achieved has been suggested. Finally, I have outlined those very important aids to export which manufacturers have employed and which they have found so essential.

I would like to add a more personal note. There are many people who genuinely feel pessimistic about our future. After five years of war and a further five of austerity, this is not surprising. We are having a tough time and I have no doubt that before long it might even be tougher. The real fact of the matter is that ever since Dunkirk and the subsequent blitz on England we have not, as a nation, felt ourselves 'up against it'

as we did in those days. The fact that we are more 'up against it' than ever has been concealed by American and other loans and gifts, *Marshall* aid and the welfare provisions of our government. Now we are beginning to learn, and in the process of learning you will see emerge the real England, the England that has always learned the hard way, the England that has before been beaten to her knees only to rise, to fight back and win. We shall do so again. In the words of William Havard, who lived in the eighteenth century when England was laying the foundations of her greatness,

> 'Our Country's welfare is our first concern,
> And who promotes the best—best proves his duty.'

APPENDIX

Memorandum of a system of multilateral contra account submitted by the London Chamber of Commerce and approved by the Sixteenth Congress of the Federation of Chambers of Commerce of the British Empire, September 1948

PRESIDENT TRUMAN estimates that the United States' excess of exports over imports on visible and invisible account for the year 1948 will be £2,000 millions on the basis of the results of the first six months. This represents a considerable fall in the surplus compared with 1947 when the figure was £2,825 millions. This means that the United States has annually £2,000 millions of foreign money for which she has no use. She does not want it for the purpose of buying goods for import, in the countries where it is legal tender. If exchanges were freed she could sell it for what it would fetch, so knocking down the exchange rates of the other countries. The other countries are not therefore prepared to free their exchanges. About the only other thing she can do is to use that money to buy up other nations' fixed assets. This also creates fear, as

nations do not want to be bought up by the United States any more than overrun by the Russians.

In these circumstances each nation does its best to cut down its imports and increase its exports. It will only import what is absolutely necessary for its economic existence. The result is that countries like France which rely on the export of luxury and semi-luxury goods to pay for their necessary imports find themselves in difficulties.

Even if countries allowed the United States to buy up their land, their industries, their hotels, cinemas and newspapers, the problem would not be solved. In the next year, not only would America have another surplus on current account, but to that would be added the dividends and interest on the fixed assets acquired the year before. Progressively, year by year, the amount which would have to be bought up would increase.

The old system which this country operated in the last century was to give loans which were then largely repudiated. For about sixty years we lent on an average £100 millions (£6,000 millions). At compound interest this figure would have reached astronomical proportions. In fact, in 1914 our foreign investments were worth £4,000,000,000; for the most part the rest had been repudiated, in spite of the fact that, unlike the United States, Great Britain was quite willing and did, in fact, take a large excess of imports over her current exports. That system, quite obviously, will not work in the case of the United States in the second half of the twentieth century. The Chamber's solution, put forward sixteen years ago, is as follows:

Exchange rates would be fixed by Convention — they have been for the last nine years.

All international trade would be done on bills of exchange. Goods could not leave the country without a bill of exchange being discounted: it would be a necessary shipping document, just as an invoice, an insurance policy and a bill of lading are now. For example, if I wish to sell a motor car for £1,000 to Smith in Boston, I should draw a bill of exchange for $4,000 on Smith. If I wished to give him 30, 60 or 90 days' credit, this would appear in the price I charged him. I should discount that bill in the ordinary commercial way with one of

the banks and receive my £1,000 less the discount rate. The bank would be under legal obligation to re-discount the bill with the Bank of England, i.e., the nation, and they would receive £1,000 less the re-discount rate. My sole anxiety would be whether Smith would prove to be an honest and solvent buyer. I should not be concerned with foreign exchange. I should, in fact, have received my money at the time I shipped my goods. If, on due date, Smith met the bill by paying $4,000 through his bank into the American Exchange Control, Smith too would have met his obligation in full and would be out of the picture. The American Exchange Control would then chalk up on the board: 'Credit the United Kingdom with $4,000.' Great Britain could not take that $4,000 and use it for any purpose. It could only clear its credit of $4,000 when the process was reversed and an English importer bought goods from an American. The English importer would pay his £1,000 through his bank into the Bank of England, which would then credit the United States with £1,000. These two amounts would then cancel out (Contra Account). This is a simple case of bilateral clearing.

To make it multilateral

In order to make it multilateral, all that would be necessary would be to have a common meeting place where the central banks of all nations would have their representatives. This would in no sense be a world bank. It would then be possible, e.g., for the Bank of England, to ring up its representative at this central clearing house and instruct him to go on to the floor of the house and try to exchange a claim on one country for a claim on another. There would be no question of buying and selling, as the exchange rates would be fixed. Through this mechanism the claims held on one country could be exchanged for claims on another, so making the exchanges three- or four-cornered (multilateral).

The essential feature of this scheme is that nations would recognise that exports could only be paid for by imports: that it was their duty and obligation to maintain their own external payments with the world in balance. To give effect to this con-

cept it would be agreed amongst the nations that if they did not clear their claims on other nations within a period of years, e.g., seven years, that claim would automatically lapse under a statute of limitations. For example, if the United States ran a surplus at the present rate of £2,000,000,000 per annum for, e.g., seven years, she would have £14,000,000,000 outstanding credits. At the end of seven years from now, credits created this year would have been in existence, uncleared, for seven years and would therefore lapse, reducing the American holding to £12,000,000,000. Of course if they did another £2,000,000,000 excess in that seventh year, the total would be back to £14,000,000,000, but at the end of the eighth year the £2,000,000,000 of credit created seven years before would also lapse, again bringing the total down to £12,000,000,000. In other words, the United States would have all the insurance against disasters necessitating abnormal imports which she could possibly need. At the same time these credits would not constitute a threat to the exchange rate of any other nation, nor could they be used to buy up other nations' existing fixed assets.

Let us now consider the position of a nation which deliberately imported far beyond its capacity to pay with acceptable goods to a willing buyer. This situation would very speedily become apparent to the other central banks. They would find that the outstanding credits which they held on that nation were growing. They would also find that when they went into the central clearing bank and tried to exchange those claims for claims on other nations, no other nation would be anxious to acquire them. They too would already have outstanding surpluses with that nation. In short, that nation's credit would become bad, and if it persisted in its misbehaviour the other nations would ration it. This they could do quite simply by informing their exporters that next quarter they would only rediscount bills drawn on the nationals of that country to a total value of, e.g., £20,000,000 instead of, e.g., £25,000,000, and that before agreeing to ship goods an exporter had better ascertain whether the delinquent nation had already used its quota for that quarter. If so, they would have to wait until the following quarter before shipping their goods.

The technique of the last century, under which loss of gold was regarded as a barometer indicating that a nation was getting out of balance, was extremely primitive. The loss of gold might, of course, be due to large capital movements and have no relationship to the trade balance.

It will be noticed that under the scheme here advocated, the central bank could know, at any moment, exactly how it stood with the world as a whole, and with every nation in it. It would make payment to its own nationals for their exports when it re-discounted their bills of exchange, and it would receive payment from its nationals for all imports when those nationals met their bills of exchange.

Interest and amortisation on foreign loans would be paid by the borrower into his national central bank, which would thereupon credit the lender's central bank, which would pay the lender. The credits created in this way would be indistinguishable from the credits created by importers paying for current imports, and could similarly only be cleared when the creditor country created a contra account by importing.

The Technique of the United Kingdom Exchange Control

By

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Although most people probably understand exchange control to be concerned only with financial transactions between the United Kingdom and other countries, properly speaking it covers the whole external trading and financial relations of the country. Indeed, the importance of external trade is paramount, since without exports foreign currency in sufficient quantities cannot be earned, and unless imports are controlled those earnings might be squandered away without providing for our essential needs. Broadly, therefore, exchange control includes the control and supervision of exports and imports. I shall touch on these aspects today, but I shall be mainly concerned with the financial control exercised by the Treasury through the Bank of England and the whole banking system acting as their agents.

Full exchange control began in the United Kingdom at the outbreak of the late war on September 3, 1939, the legal basis of the purely financial control being the Defence (Finance) Regulations issued under the Emergency Powers (Defence) Acts. In October 1947 these temporary wartime powers were superseded by permanent legislation in the shape of the Exchange Control Act, 1947, which, except as regards the control of securities, carried on with only minor changes the form of control that had been built up during the war years. The wide powers contained in the Act are vested in the Treasury, who are responsible for exchange control policy and its administra-

tion. Most of the latter is in practice carried on by the Bank of England as agents for the Treasury, whose advisers they are also on policy. In turn the Bank of England has delegated to virtually the whole of the banking system a wide variety of powers to deal with exchange control questions on the basis of detailed instructions issued principally in the form of Exchange Control Notices to Bankers but sometimes by specific letters of authority. In their various fields powers have also been granted to stock exchanges, registrars, travel agents and others, the object being to decentralise every aspect of control to the greatest possible degree so that it shall impede the legitimate trade and business of the country as little as possible.

The Act operates mainly on a territorial basis. Residents of the United Kingdom are fully subject to its provisions, being obliged, among other things, to surrender gold and certain foreign currencies specified by the Treasury and not to make payments in sterling or foreign currency to non-residents without permission. Non-residents are in the main affected only if they hold sterling balances or securities. But between these two categories comes another: residents of the other parts of the Sterling Area (or Scheduled Territories as they are called in the Act). These Sterling Area residents are not, of course, subject to our Act, but under it payments to them in sterling are freely permissible. This is made possible by the fact that each of the territories concerned employs exchange control on lines broadly similar to our own. Together, therefore, they form with the United Kingdom a unit surrounded by an exchange control fence, so to speak, of roughly equal height. The protection which this gives enables the United Kingdom to continue to fulfil its traditional role of banker to the Sterling Area and to allow sterling to flow freely to all parts of it, bringing all the trading and other advantages arising from the use of sterling as an international currency which were described so admirably by Sir Henry Clay in his talk on the Sterling Area at the Summer School last year.

In describing the detailed machinery of control, I am not going to take you through the Act paragraph by paragraph. Instead, I shall try to tell the story in what seems to be a logical sequence, starting with the gathering-in of foreign ex-

change and gold, passing then to payments abroad out of these resources, to the control over credits and to export and import controls against capital efflux. Next I shall describe the different types of non-resident account to which sterling payments are made, touching on the present restrictions on the international use of sterling and concluding with an outline of the arrangements for controlling securities.

The Treasury have wide powers under the Act to determine the residential status of any person to whom it may apply. No precise definition of the term is possible: cases have to be treated on their merits in the light of the facts. But in all but a small minority of cases no doubt arises. For most of us the facts as to our place of permanent residence are self-evident.

All residents of the United Kingdom are obliged to surrender to an authorised dealer against payment in sterling at the official Bank of England price or rate of exchange all gold coin and bullion and specified foreign currency which they are entitled to sell, unless they have been given permission to retain it for a particular purpose. Gold must almost invariably be surrendered, except by gold dealers and manufacturing jewellers operating under licence, and retained foreign currency accounts, which are subject to supervision, are principally allowed to firms with important trading interests abroad. Foreign nationals resident in the United Kingdom may apply for a measure of exemption in relation to holdings of the currency of their own country where this is a specified currency. The list of specified currencies, which is not immutable, contains those of a number of countries having monetary agreements with the United Kingdom, besides most other non-Sterling Area currencies which are useful for making payments abroad. The list does not contain any of the other currencies of the Sterling Area which residents may freely buy and sell. The authorised dealers are obliged to surrender the gold and foreign exchange which they collect to the Bank of England, who hold it in the Exchange Equalisation Account. In this way the Exchange Control gathers into the central pool the essential means of payment abroad.

The most important source of foreign exchange is, of course, the proceeds of our exports. Indeed, so vital are they that the

Act provides for machinery to ensure that they are received in full, within a reasonable time and in the right currency, by the central pool. The responsibility for this lies with the Bank of England and the Customs under s. 23 of the Act. Every exporter has to complete a Form C.D.3 in respect of each shipment, giving details of it and its destination and stating when and in what manner payment will be received. The form is in duplicate and is handed to the Customs when the goods leave the country. They keep one half and return the other to the exporter, who must receive payment within six months unless he has the permission of the Bank of England in an exceptional case to give longer credit or export on other terms. When payment arrives the exporter must send his half of the C.D.3 form to his banker together with the relative invoices in order to obtain a certificate that payment of such and such an amount has been received by an approved method. The banker afterwards passes the form to the Bank of England, who check it and then send it to the Customs for a further check, particularly as to the correctness of the valuation of the goods. Finally, the Customs marry the second half of the form to the first, and the Exchange Control check so far as that particular export is concerned is complete. The first halves of the C.D.3 forms which the Customs keep as the goods go out provide them with a record enabling them to follow up cases where payment for an export is unduly delayed. The system also enables the Exchange Control to see what credit terms are being sought by foreign buyers. Where United Kingdom goods are exported *via* an intermediary in another part of the Sterling Area or *vice versa,* co-operation between the United Kingdom and the Sterling Area Exchange Control concerned ensures that the C.D.3 check is nevertheless maintained.

Of course, a large proportion of our exports is paid for with non-resident sterling, when no foreign exchange accrues directly to the central reserves. Instead, there is a reduction in the potential claims abroad on our goods and services, which for balance of payments purposes has precisely the same effect as if foreign exchange had been received.

Control over the receipt of financial remittances from abroad, e.g., freights, insurance premiums and claims, royal-

ties, fees, etc., rests in the obligation placed on residents neither to divest themselves of the right to receive such payments due to them in sterling or a specified foreign currency nor to delay their payment.

An active control is exercised over foreign investment or trading companies in which residents of the United Kingdom have a controlling interest. By Treasury direction the United Kingdom shareholders, who may not divest themselves of control without permission, can be obliged to secure the surrender of gold and specified foreign currency held by such companies, or to require the payment of a dividend, or obtain any information, or follow any other course of action the Treasury may require. These powers have been the means of securing large amounts of foreign exchange for the United Kingdom reserves, but they are exercised with due regard to the legitimate trading interests concerned and rarely in the case of a public company with numerous shareholders whose shares are quoted in the United Kingdom.

Conversely, permission is required before any United Kingdom resident may make a loan to any firm, resident in the Scheduled Territories, which is by any means controlled directly or indirectly by non-residents. This enables the Control to ensure that non-resident interests wishing to establish or extend the operations of subsidiary companies within the Scheduled Territories shall provide by remittance a reasonable proportion of the capital required. Non-residents who wish to exploit the resources or markets of the Scheduled Territories cannot expect to be allowed to work entirely on money borrowed in the United Kingdom and by taking a proper stake in such ventures they incidentally augment our central exchange reserves.

Another important way in which we earn foreign currency or reduce non-resident-owned sterling is by the sale to non-residents of foreign currency securities owned by residents of the United Kingdom. I shall be describing at the end of this talk how such sales and the receipt of their proceeds are controlled.

Having shown how foreign exchange is gathered in, I now

turn to the control over its use. In large measure this day-to-day control has been delegated by the Treasury to the Bank of England, who, as I have already explained, have in turn passed on as much authority as possible to the authorised banks so as to avoid the delays which an over-centralised control would cause.

The control of payments under Part II of the Act has the object of prohibiting any unauthorised call, direct or indirect, on the exchange reserves of the United Kingdom. In the first place, permission must be obtained for all payments made in the United Kingdom to persons outside the Scheduled Territories. This holds good whether the payment is a straightforward one, as, for example, when made to a bank account of a non-resident, or whether it is made to another resident of the Scheduled Territories by order or on behalf of a non-resident. Payments from one banking account to another, in cash, or by book entry between firms having relations with each other, are all covered by this requirement which applies equally to the person making the payment and the person receiving it on behalf of the non-resident concerned. The majority of transactions affected are, of course, payments made in sterling from one banking account to another. The stipulation applies even in respect of payments from one non-resident account to another and provides the basis for the control over the use of non-resident sterling, about which I shall say more later: exemptions have been made to enable such sterling to be transferred within defined limits and also to legalise petty cash transactions, both between foreigners in this country and between foreigners and residents.

Secondly, no resident of the United Kingdom may, without permission, make a payment abroad to or for the credit of a person resident outside the Scheduled Territories. In other words, all payments in foreign currency require permission.

Finally, no compensation transaction may be entered into without permission. That is to say, nobody in the United Kingdom and no resident while outside the United Kingdom may make a payment to or for the credit of a person resident in the Scheduled Territories in return for which someone receives a payment or acquires property outside the Scheduled

Territories. This is a most essential provision. It is true that when a compensation takes place 'no money leaves the country', as those who wish to indulge in such transactions so often plead; but equally none comes in when it should, and the central reserves are as much the loser as if a payment out of them had been authorised.

Application to make payments abroad must be made through a banker on the appropriate exchange control form. They may be made in sterling or foreign currency. For example, a payment to the U.S.A. may be made in U.S. dollars or in sterling. From the balance of payments point of view it is immaterial which method is used, though in a particular case there may well be commercial or other reasons for choosing one rather than the other. Payments in foreign currency are made by buying it from an authorised dealer at the official Bank of England rate if one is quoted for the particular currency required. No resident in the United Kingdom may deal in foreign currency at other than the official rates of exchange or, unless he has been allowed to hold a retained account or make other special arrangements, without an authorised dealer being one party to the transaction. The object of these provisions is to prevent the development of unofficial exchange markets which would divert exchange from the central pool and tend to undermine the official rates of exchange. Payments in sterling are made by transfer from resident to the appropriate type of non-resident account once permission to do so has been obtained. The banker holding the resident account is responsible for not allowing the payment until he holds the relative approved sterling transfer form or he has been advised by the bank receiving payment on behalf of the non-resident that the form has been exhibited to them. Approved sterling transfer forms and Forms E for the purchase of foreign currency, when discharged by the completion of the transaction to which they relate, are returned to the Bank of England, who check them and compile an important part of the statistics of exchange control from them.

Dealing with applications to make payments abroad is naturally one of the most important tasks of the Exchange Control, and it is in this field that perhaps the greatest measure

of decentralisation has been possible. The 111 authorised banks are permitted to approve many types of payment without reference to the Bank of England. The chief of these is payment for imports. The flow of imports into the United Kingdom is regulated by import licensing administered by the Board of Trade. But this is under the general supervision of the Treasury, since the amount that can be spent on imports is a financial question. Once an importer has obtained his import licence, the granting of permission to pay his foreign supplier follows automatically and as soon as he cares to make the necessary application to his bank, supported by evidence that the order has been placed. This system ensures prompt payment for all permitted imports.

The Customs are responsible for an essential part of the exchange control procedure in relation to imports. They see that the goods which are paid for do in fact come in and that they are full value. The exchange control application forms to pay for imports are issued in duplicate. If the importer wishes to pay before the goods have arrived, he merely submits an invoice in support of his claim. After his application has been approved and payment made, he keeps the duplicate form until the goods arrive, when he obtains from the Customs a special exchange control copy of the Customs entry. This he attaches to his duplicate form, which he then surrenders to his bank, who pass it to the Bank of England. There it is checked and passed to the Customs for further checking, particularly in respect of the valuation of the goods. The original of the application form has already reached the Customs through the same channels, and when this and the duplicate are married the exchange control check is complete. Where the completion of this process is unduly delayed because the duplicate form has not come forward, the Customs make enquiries of the importer. The authorised banks may also approve payments for imports into other parts of the Scheduled Territories provided they are satisfied that the relative local Import Licensing and Exchange Control requirements have been fulfilled. Approved applications are eventually sent by the Bank of England to the local Controls to enable them to complete their exchange control check. In fact, as you will already have

observed, the exchange control procedures in relation to imports and exports follow the same pattern.

The remaining applications to make payments abroad may be divided into three broad categories. Those in respect of contractual liabilities, mainly of a commercial nature; those in respect of particular classes of non-contractual payments that the Treasury have decided in principle may be allowed within stated limits; and those which have to be considered on their own particular merits. The authorised banks are permitted to deal with most applications falling within the first two categories, although they have only partial authority in respect of certain classes of payment. It would take too long to give full details of the two categories, which together cover most types of current payment, but the first includes the bulk of those commercial payments, such as interest and redemption payments in respect of sterling securities, freights, ships' disbursements, canal dues, insurance premiums and claims, and patent fees, which must be paid—and with as little official formality as possible—if the commercial life of the country is not to be seriously impeded. The second category consists largely of foreign exchange required for travel abroad for various purposes. The Treasury have fixed the maximum amount which may be allotted for each purpose. The most important classes of business traveller, for example, may spend up to £8 a day in Europe and up to £10 a day elsewhere outside the Scheduled Territories, and the banks may authorise such expenditure for limited periods, applications covering visits for longer periods being referred to the Bank of England. Applications for the Basic Travel Allowance available for personal travel, e.g. holidays, during the current year in certain foreign countries are dealt with by the authorised banks and certain of the travel agencies. The former may also grant limited amounts of foreign exchange to those who must go abroad for health reasons, for the education of children abroad and to emigrants from the United Kingdom.

I come now to those payments which are authorised only by the Bank of England. These applications, as I have said, are those where individual merit is the deciding factor and where consequently the Exchange Control has to exercise

judgment after sifting and weighing evidence. I do not mean to imply that there are no rules covering such applications. Far from it. The Control's attitude in principle to most classes of application has been formulated, but it remains to decide whether each particular application does or does not pass the tests.

The applications dealt with by the Bank of England concern both commercial and non-commercial, i.e., largely personal, payments abroad. And within each of these categories some payments are of a current and some of a capital nature. Many of the current commercial payments arise under agreements which the applicants wish to conclude with firms abroad in respect of, for example, the sale of the latter's products in particular markets, the use of technical 'know-how' in United Kingdom manufacturing processes or to acquire the publishing rights relating to music and books, etc. Payments under pre-war agreements of this nature are permitted, but the assumption of new obligations of the same sort is allowed in the main only if this appears to be in the national interest on exchange and other grounds on which interested government departments, and in particular the Board of Trade, give their advice. The remittance of the current trading profits of United Kingdom subsidiaries of foreign companies is also permitted, and applications for this purpose require careful scrutiny in order to check the basis on which the profits in question have been calculated and to ensure that proper provision for outstanding tax liabilities has been made.

Applications concerning capital payments of a commercial nature are numerous and of infinite variety. A country which no longer has a surplus in its international balance of payments obviously cannot afford to spend exchange freely on foreign investments, however attractive they may be purely as investments. But exchange must somehow be found to nourish our remaining worthwhile foreign assets and to build new ones which will bring direct benefit to our export trade or reduce our import requirements or develop the production of raw materials we need for our industry. The export of capital for such purposes helps us to reach the equilibrium we are trying to achieve. This is the broad context in which numerous

applications to put further capital into existing companies abroad or to start new ones or branches of United Kingdom concerns are considered week by week in collaboration with the Treasury, Board of Trade and other government departments.

Applications to make current non-commercial payments abroad cover a wide field and include salaries of employees abroad, upkeep of property abroad, alimony, the cost of post-graduate education. Among the most difficult to deal with are applications covering payments to relatives or friends abroad who are incapacitated or without resources, or both, and for travel abroad on compassionate grounds. Both the individual amounts applied for and the total thereof are not large compared with most other categories of payment. Their significance lies in the fact that, on the one hand, the United Kingdom gets little or no material return for most of this expenditure, which accordingly has to be closely watched, and on the other that much of the good repute of the Control depends upon fair and reasonable treatment being given to the many small personal applications involved. This may not sound a difficult task, but, with hundreds of applications flowing in each week, general rules must be laid down for the guidance of officials who would be more than human if they did not occasionally fall into the error of making the case fit the rule instead of *vice versa*. Moreover, I am afraid that many people, while expecting the most enlightened attitude from the Control, give it very inadequate information on which to work.

The chief remaining non-commercial payments include those by charitable and missionary societies for work abroad. Such remittances, which are allowed more freely to those countries with whom we are not in deficit than to the remainder, may be made only by recognised bodies and not by private individuals—this is a safeguard against abuse of the facility by persons desiring to export capital.

The export of capital by persons leaving the United Kingdom to take up permanent residence outside the Scheduled Territories is allowed within modest limits. The foreigner returning to his own country may take his allotment all at once and, immediately after departure, becomes a non-resident eligible to receive any future sterling income or other transfer-

able sterling payments due from the United Kingdom. The British national, or foreign national going to a country other than his own, gets his allotment in four equal annual instalments and becomes non-resident only when four years have elapsed after his departure. In all cases elaborate steps are taken to ensure that no transfers in excess of the concessions are made either directly or indirectly.

Finally there are those few payments of a capital nature, some commercial and some not, which, although contractually due to non-residents, the country's exchange position does not enable us to transfer for the time being. It would not be reasonable to deny those residents concerned any means of obtaining a good discharge for such contractual liabilities. They are therefore allowed to make payment provided they do so to a Blocked Sterling Account in the name of the beneficiary, who may not use or transfer funds thus received except for investment in British Government securities maturing in not less than ten years from the date of investment. Various types of payment have from time to time been put into and taken out of this category, the chief now included being payments due to non-residents on the liquidation or winding up of United Kingdom companies controlled by them and sums arising from the sale of non-resident-owned property in the United Kingdom.

The description I have given of the kinds of payment allowed and how they are dealt with is not exhaustive, being intended merely to give you the general picture as it is today. There is no guarantee that it will not change, although I am sure the Control will not lightly abandon its twin objectives of facilitating current transactions as much as possible and detecting and controlling capital transfers. It seeks to co-operate with all Exchange Controls abroad who accept these principles and to encourage others to do so.

A good example of the efforts made, under difficult conditions, to reduce day-to-day exchange control formalities to the minimum is the special arrangements designed for commodity markets. After the end of the war, when the re-opening of some of the London commodity markets was being considered from the point of view of exchange control, it was

realised that if such a market were to flourish it must be able to operate with something approaching the freedom of pre-war days. A world market can fully live up to its name only if it is free to buy and sell anywhere and on any terms, and to hold stocks of the commodity in which it deals. The existence of such a market, whether in a Sterling Area or non-Sterling Area commodity, thus demands a freedom and speed in the granting of exchange for all its legitimate purposes which the ordinary exchange control procedure is unable to provide. To meet this need, a special form of exchange control procedure was drawn up which it was hoped would, subject to possible minor adjustments, be suitable for any commodity market which might be revived. Participation in such a special arrangement is limited to firms which are members of a commodity market association, such as the Rubber Trade Association, which in return for the greater freedom enjoyed by its members undertakes to accept responsibility for their observance of the Control's requirements and, if need be, take disciplinary action against any defaulter. The exchange control conditions under which participants may trade are laid down in the scheme and their bankers are given authority to deal with their applications for exchange or to open credits. All financial transactions covered by the scheme must be passed by each participant through a special bank account, of which monthly statements are sent to the Bank of England together with statements compiled from the participant's own books of his business both spot and forward during the month. An aggregation of such statements enables the Bank to keep a watch month by month on the position of the market as a whole and in consultation with market representatives to ensure that no unhealthy position, such as the locking up of an undue amount of foreign exchange in commodity stocks, is allowed to develop. These arrangements provide for the operation of a futures market where this is required and permit participants to deal, under suitable safeguards, in futures markets abroad. So far the arrangements apply in full only to the London Rubber Market. The London Coffee Market, which was the first to re-open, at first enjoyed similar facilities, but, since it deals in a commodity coming largely from hard currency countries, it has unfor-

tunately been necessary to place increasing restriction for the time being on its freedom of operations.

Another example of adaptation to special circumstances is seen in the efforts made to preserve the City of London's traditional business of financing world trade.

It frequently happens that a seller of goods or manufactures wishes to ensure that he will receive payment on delivery, or at an agreed time after delivery, and he may wish to receive this assurance before he despatches his goods or, indeed, begins to manufacture specialised machinery. This assurance is provided by the use of a London banker's irrevocable sight or acceptance credit. Sometimes a revocable credit satisfies the seller, but in either case, once they have been established, opened or advised, etc., the bank concerned, and indeed the London market as a whole, cannot afford lightly to withdraw such facilities even though the terms in a particular case may not be legally irrevocable. Where, therefore, credits involve payments to or from non-residents or are denominated in a foreign currency, it behoves the opening banker, before he commits himself, to obtain Exchange Control approval of the terms. He is required to do so on Form E.2, which is lodged with the Bank of England. Documentary credits covering imports into the United Kingdom or exports from the Sterling Area, including the United Kingdom, may be approved by the authorised banks provided the period of validity of the credit does not exceed nine months and that, if payment is not made against documents, drafts are not drawn with a longer usance than 120 days. In the case of imports, any necessary import licence must be held and in the case of exports payment must be received from the correct type of non-resident account. Extensions making the credit valid for up to twelve months in all—and exceptionally for longer periods—are permitted. All drawings or payments under approved credits in favour of non-residents require formal approval by an authorised bank like ordinary payments in sterling or foreign currency. Credits in respect of imports into Sterling Area countries outside the United Kingdom, which are opened with the prior approval of the appropriate local Control, do not require the approval of the Bank of England, but must be registered with an

authorised bank before payments or negotiations are effected.

Overdrafts, other than those required for a few days for technical reasons, are not normally permitted.

All guarantees require approval on Form E.2 and are closely scrutinised.

The control over foreign exchange receipts and expenditure must of necessity be reinforced by control over the import and export of goods, securities, bank notes and other valuables. This control is mainly exercised at the ports as persons and things move in and out of the country and is administered on the spot by immigration officers and officers of Customs and Excise. Postal controls naturally involve the co-operation of the Post Office. The cases and questions thrown up by these officers are referred either to headquarters, or direct to the Bank of England according to their character.

I have already dealt with the control over the import and export of goods, and I shall cover securities and coupons later on. The chief remaining item is sterling Bank of England notes, the import and export of which is forbidden except that £5 in such notes may be taken out and brought into the country by a traveller. United Kingdom residents who take sterling notes out may spend them on British ships but not anywhere abroad, the object of the concession being solely to make it possible for incoming or returning travellers to meet their initial disbursements without inconvenience on arrival in the United Kingdom. An export ban alone would not be sufficient to prevent the export of capital in notes since freedom of import would maintain the value of sterling notes abroad and thus encourage their illegal export. Before the import ban was imposed in 1940 non-resident holders of sterling notes were given a reasonable opportunity of obtaining credit for their holdings, and minor clearing up of the pre-war condition is still going on, although naturally after such a lapse of time credit for non-resident holdings is no longer readily given.

The export of all non-Sterling Area currency notes is also forbidden. Such notes become legal tender when imported into the country of issue and could, therefore, be used to make payments not permitted through banking channels. The same rule applies to foreign currency bills of exchange and travellers'

cheques. An exemption enables travellers to take abroad in foreign notes of the appropriate type up to £10 of the currency granted to them for their journey. Non-residents visiting the United Kingdom with any of these instruments can avoid inconvenience on departure by having the amount and nature of their holdings marked in their passports on arrival.

There is also a ban on the export of gold coin and bullion which reinforces the requirement to offer such assets for sale to an authorised dealer. The legitimate activities of gold dealers and of manufacturing jewellers are covered by licence or permission.

Treasury Bills are treated as cash and may not be imported or exported for the same reasons as apply to sterling bank notes, while a ban on the export of postal orders supports the arrangements made through banking machinery to secure that the proceeds of such instruments are not credited to non-resident accounts. These measures in respect of postal orders are necessary because they cannot be given the individual scrutiny which is applied to cheques on banks in order to ensure that any necessary Exchange Control consent has been obtained.

Life assurance policies which can be readily assigned for value or, in some cases, encashed before maturity may not be exported without permission; this is readily given, however, where the object is to obtain payment at maturity of policies issued outside the United Kingdom or endorsement of policies issued by the United Kingdom branch of a company whose head office is abroad.

The export of portable articles of high value constitutes an easy means of exporting capital and of obtaining foreign exchange other than through the proper channels. If such articles are exported otherwise than in the baggage of a traveller they become subject to s. 23 of the Act and therefore to the requirements I have already described. A traveller carrying such things as furs, precious stones or jewellery, works of art or even postage stamps, etc., comes under the eye of the Customs who have to be satisfied before export is permitted.

Before the war sterling was a true international currency acceptable everywhere and freely transferable between holders

in all parts of the world. Exchange control in the United Kingdom raised the first barrier by making the transfer of sterling from the accounts of residents of the Sterling Area to accounts of non-residents subject to permission. This was and is an indispensable part of the system which need not of itself seriously interfere with the international use of sterling. Increasing exchange difficulties from 1940 onwards, caused mainly by the need to obtain goods from non-Sterling Area countries in exchange for sterling not immediately exchangeable into goods in return owing to the demands of war on our productive capacity, made it necessary to conclude bilateral financial arrangements with more and more countries until, by the end of the war, such arrangements had been made either by agreement or unilaterally covering nearly all the important countries or groups of countries outside the Sterling Area. Under such arrangements the non-Sterling Area country or group concerned could use its sterling only within the Sterling Area and not for purchases in other countries or groups outside it. Those who agreed to hold sterling under these conditions exercised control over its use by their residents and undertook to see that it was used only at the official Bank of England rates of exchange.

In order to ensure that sterling did not pass from one such area to another without permission, all non-resident accounts were designated according to the group or country concerned. For example, all sterling accounts of persons resident in the French Franc Area, consisting of France and the French Empire, were designated French Accounts, and similarly with the Belgian, Dutch and Portuguese monetary areas. Accounts of residents of Argentina became Argentine Accounts, and so on. This strict bilateralism was a necessary evil which could be relieved by sterling transfers from one area to another only by administrative action when tolerable on balance of payments grounds. Subsequently as a member of the International Monetary Fund the United Kingdom undertook 'to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade' and later in the Anglo-American Loan Agree-

ment to restore the convertibility of sterling into other currencies by July 31, 1947.

In preparation for the latter event, the United Kingdom Exchange Control began early in 1947 to forge sterling links between an ever-widening circle of the non-Sterling Area countries and groups by introducing the system of Transferable Sterling Accounts. The purpose of these accounts was to provide a channel through which sterling payments could be made in respect of current transactions between the countries included in the system. Responsibility for ensuring that only payments in respect of current transactions were made rested with the Central Bank or Exchange Control in each of the countries concerned, and accordingly their consent had to be obtained for each transferable account opened by a resident in their country. Usually only banks had them, since otherwise effective supervision would have been impossible. By making the balance of transferable accounts transferable to American Account and thence into U.S. dollars, the terms of the undertaking in the Anglo-American Loan Agreement were in large measure fulfilled before the due date, but the heavy drain on the exchange reserves of the United Kingdom which followed brought about the reversal of this step a few months later. Nevertheless, although convertibility into U.S. dollars had to be suspended, a large part of the transferable account system survived. Some countries have since been withdrawn from it entirely and others added, but the ultimate objective remains unchanged. Meanwhile the Control continue to strive to promote the international use of sterling by administrative action. Unfortunately for the time being this entails constant reference to the Bank of England by foreign central banks and merchants both within and outside the Sterling Area. The latter in particular no doubt deplore the frequent inability to carry through good business because facilities for trading in sterling are not forthcoming and they may not always find it easy to understand why this is so, not perhaps having the advantage of seeing the picture of the general balance of payments situation by which the Control must be guided.

The objects underlying the control of securities are naturally similar to those relating to payments: they are, on the one

hand, the conservation of foreign currency assets in the form of securities and, on the other, the prevention of direct or indirect exchange losses through unauthorised transactions in securities.

The measures taken to these ends must ensure that both foreign currency and sterling securities which are United Kingdom owned do not pass into non-resident ownership unless appropriate consideration in foreign currency accrues to our Control, and that those which are non-resident owned are not sold in the United Kingdom, or to persons resident here, without the permission of the Control.

There are two types of securities to be dealt with: those registered in the Scheduled Territories and those registered outside those Territories or in bearer form. The control of securities registered in the Scheduled Territories is exercised by imposing restrictions on actions by registrars and others. In the United Kingdom these actions include giving effect to transfers, registering non-resident addresses and making payments in respect of income or capital to non-residents. Since the transfer of such securities can be effected only by an entry in the appropriate register, it is not necessary to restrict the import or export of the certificates relating to them.

The control of securities transferable in registers outside the Scheduled Territories and of bearer securities transferable by delivery is effected by physical control over the certificates of title to the securities. All such certificates of title, whether belonging to a resident or a non-resident, which are physically held in the United Kingdom must be deposited with an authorised depositary, who may not thereafter part with them except to another authorised depositary or as the Treasury may otherwise permit. Certificates of title belonging to residents which are held outside the United Kingdom must be held to the order of an authorised depositary on the same terms. All the principal banks and the Share and Loan Department of the Stock Exchange are authorised depositaries, and thus it is ensured that all such certificates of title are under the physical control of persons who can be trusted not to allow them to be transferred or dealt with in any way except in accordance with the rules of the Control.

In order, however, to facilitate normal market transactions in such securities, a limited class of persons called Temporary Recipients is permitted to withdraw securities from an authorised depositary provided that they are re-deposited within a period of thirty days; a temporary recipient may deliver such a security only to another temporary recipient, who thereby assumes the responsibility for re-depositing within the stipulated period. The list of temporary recipients is widely drawn to include all persons whose activities are such that they would normally be expected to handle securities, e.g., stockbrokers, solicitors, etc. Thus, once deposited, no security covered by these arrangements ever moves outside the control of one or other of the Treasury's agents.

But the first step is to ensure that the securities are deposited, and this might not always happen if a holder felt he could ignore his obligations with impunity. He has therefore been given strong inducements not to do so. No certificate which ought to be deposited but has not been can legally be bought, sold or transferred in the United Kingdom to anyone resident or non-resident; no capital or income can be paid in respect of it in the United Kingdom; in fact, nothing can be done with it effectively until it is deposited. Moreover, bearer securities must be lodged complete with all the coupons that ought to be there, thus preventing any irregular market in or use of them. Nor does the mere deposit of a security end the holder's troubles. He must produce satisfactory evidence of ownership, and must show in particular that there is no enemy interest in his security, before it can become good delivery on the Stock Exchange and before he can touch any income or capital payments on it. Meanwhile all such payments are collected by the authorised depositary and kept in suspense.

Even so, other safeguards are necessary. A security which appears on a foreign register or is in bearer form will usually be saleable abroad quite readily if only the necessary certificate of title can be exported. Such certificates therefore provide a ready means of taking capital out of the country. This applies particularly to bearer securities which, popular though they are in international markets because of the readiness with which they can be passed anonymously from hand to hand, are

for that very reason anathema to all Exchange Controls. Two steps have been taken to meet this danger. The first is a ban on the export or import of all bearer securities or certificates of title to securities registered abroad, whether owned by residents or non-residents, and a ban on the export of coupons except for the purpose of collection. The ban on the import of such securities without approval, the reason for which might not be apparent at first sight, reinforces the control on their negotiation in the United Kingdom. It would clearly be easier for a non-resident to realise his securities in the United Kingdom and thus obtain a cash claim on the central foreign exchange reserves if he were able to import and deliver the certificate of title to the purchaser in the case of a bearer bond or to the registrar in the case of a registered security. The second step is a general prohibition on the issue of new bearer securities in the United Kingdom, exception being made only for purely temporary documents, such as allotment letters, letters of rights, etc., which must be registered in the United Kingdom within a short period. Registration in the name of non-residents is permitted only where the Control is satisfied that the funds used to acquire the securities have come from an appropriate source. The issue of United Kingdom Government Treasury Bills which are in bearer form is not, however, prohibited nor are such bills required to be held by authorised depositaries.

The measures I have described provide the foundation for an effective control over dealings in all types of security in the United Kingdom and over securities held by residents of this country whether such securities are physically located here or not. Except in the case of Prescribed Securities, to which I will refer later, the following requirements must be fulfilled before any transfer of securities may take place without permission:

(*a*) The transferor must not be resident outside the Scheduled Territories or the nominee of a person so resident, and a declaration to this effect by an authorised depositary or a temporary recipient must be furnished when the process of transfer is set in motion.

(*b*) The transferee must not be resident outside the Scheduled Territories or the nominee of a person so resident, and an authorised depositary or a temporary recipient must similarly testify by declaration that this is so.

(*c*) The Treasury must be satisfied that (*b*) is correct in the case of transfers of all securities not registered in a register in the United Kingdom.

The Treasury does not require to be satisfied in the case of transfers on registers in the United Kingdom where (*a*) and (*b*) are fulfilled, since registrars themselves are legally bound not to enter the transferee's name in their books unless the transfer is accompanied by the necessary declarations given by authorised depositaries or temporary recipients. Transfers in registers elsewhere in the Scheduled Territories are subject to the requirements of the local Controls.

Transfers of securities registered in the United Kingdom where a non-resident or his nominee is either the transferor or the transferee may not be put through unless authorised by an authorised depositary. If the transferor is a non-resident, such authority cannot be given unless an authorised depositary declares that a licence to sell has been issued by the Bank of England. Normally speaking, a non-resident would not be granted such a licence except to enable him to switch into another security, so far as this facility is available, or to sell to another person resident in the same country or monetary area as himself. Where the transferee is a non-resident or the nominee of a non-resident, approval can be given if an authorised depositary or temporary recipient has declared the country of residence of the transferee and certified that the consideration money has been debited to an appropriate type of non-resident account, or, where a switch has taken place, from the sale of other securities, when the number of the Bank of England licence must be quoted. Transfers so authorised may be put into effect by registrars, who may record the appropriate non-resident address for the transferee. Authorised depositaries are also empowered to authorise certain special types of transfer, for example, transfer by bank nominees to non-resident owners and *vice versa*.

A similar procedure applies to transfers of bearer sterling securities and foreign currency securities other than Prescribed Securities, except that as the transfers are not the subject of scrutiny by a United Kingdom registrar they must in all cases, i.e., whether or not a non-resident or his nominee is a party, be authorised by an authorised depositary before transfer is effective. Licences for the sale in the United Kingdom of non-resident owned foreign currency securities are not given by the Bank of England.

Where the Treasury consider it expedient to do so, they are empowered to 'prescribe' securities payable or optionally payable in specified currencies and, except with Treasury permission, no person resident in the United Kingdom shall transfer or do anything which affects his powers in relation to such securities, the object being, of course, to conserve these valuable foreign currency assets. The Treasury have exercised their powers to the extent of 'prescribing' securities payable or optionally payable in the currencies of Argentina, Belgian Monetary Area, Canada, Newfoundland, Sweden, Switzerland and U.S.A. Such securities owned by residents of the United Kingdom may be transferred only between such residents or sold to non-residents against payment in appropriate foreign currencies. Residents elsewhere in the Scheduled Territories may sell such securities to United Kingdom residents but may not buy from them; non-residents are not permitted to sell prescribed securities in the United Kingdom. The procedure for transfers is substantially the same as that for other securities. All transfers require authorisation by an authorised depositary, who may not allow them unless satisfied that the transferee is a resident of the United Kingdom.

That is the end of my story. I hope you will have found its outline at least fairly complete and clear. In detail I know it lacks much, but I did not feel justified in wearying you with more. Those of you who find I have left out the very things you most wanted to know will shortly be able to submit me to rigorous cross-examination, when I will do my best to answer your questions.

The Place of United Kingdom Shipping in Foreign Trade

By

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THE industrial expansion of the nineteenth century was accompanied by a rapid increase in world shipping, the tonnage in 1900 being about five times as great as in 1800. Throughout the century the United Kingdom owned between 40 and 50 per cent of world tonnage and the peak of her importance occurred about 1905, when she owned 50.4 per cent of a world gross registered tonnage of 28.743 millions. Her share of world tonnage then began to decline; her mercantile fleet continued to increase but did not grow as fast as that of the rest of the world. In 1925 she owned 32.1 per cent of a world tonnage of 60.103 millions; in 1935 the percentage had fallen to 28.2 per cent of a world tonnage of 61.247 millions; and at the end of 1948 she owned 21.2 per cent of a world tonnage which had grown to the record figure of 81.9 millions, more than three times the tonnage in 1900. Thus, whereas about forty years ago we owned half the world fleet, nowadays we own little more than a fifth.

These tonnage figures, however, do not quite reflect our relative importance in international sea transport. They include a certain amount of small craft which ply inside coastal waters and some non-trading vessels such as fishing trawlers. A better idea of the relative volumes of tonnage in the ownership of different nations can be obtained from the following table, which gives the tonnages of ships over 500 gross registered tons in size.

TABLE I. *World tonnage by nationality,* 1939 *and* 1948

(Steam and motor vessels of 500 g.r.t. and over, excluding lake and river tonnage and miscellaneous craft such as tugs and trawlers)

	Sept. 3, 1939 (000 g.r.t.)	Dec. 31, 1948 (000 g.r.t.)
United Kingdom	16,982	16,046
Denmark	1,093	1,037
France	2,748	2,462
Germany	4,185	141
Greece	1,763	1,298
Holland	2,792	2,640
Italy	3,322	2,085
Japan	5,427	1,200
Norway	4,686	4,213
Russia	1,154	1,250
Sweden	1,442	1,841
United States	8,722	30,658
Other Countries	7,200	12,359
Totals	61,426	77,230

The most striking feature of this table, of course, is the very heavy increase in U.S.A. tonnage in the last ten years. But here again, in assessing the relative importance of the U.K. position, we have to remember that much of this American tonnage is not trading. At December 31, 1948, over 13 million g.r.t. were laid up in the United States Maritime Commission's Reserve Fleet and about 3.5 millions were employed in domestic trade (coastwise, intercoastal and 'non-contiguous' trade, e.g., to the Philippines). The total world tonnage actually engaged in foreign trade was probably not more than 60 million g.r.t. at the end of 1948, and the U.K. share was therefore about 25 per cent, a rather higher proportion than the pure tonnage figures would suggest.

The distribution of tonnage among different nations at the end of 1948, as given in Table 1, is not by any means a stable postwar norm. The ex-enemy countries, and particularly Germany and Japan, have hitherto been restricted from building

ocean-going tonnage. But this cannot last for ever. Permission has already been given to the Germans to build deep-sea vessels up to 7,200 gross registered tons in size. The building of merchant ships in Japan is now actively encouraged by the occupying power, and some months ago I saw a letter from a Japanese firm to a British shipowning company with headquarters on the Tyne itself soliciting orders at prices well below what British shipbuilders could offer. From building for foreign account to building for national account is a short step; and there can be little doubt that before long pressure will begin to be felt from Germany and Japan for a restoration of their national fleets to something like a prewar level.

In addition, several nations are declaredly trying to build up national merchant fleets. Argentina and Brazil provide instances of foreign countries, Australia and India instances of Commonwealth countries. Canada had 1.807 million g.r.t. at the end of 1948 as compared with 0.358 million g.r.t. at the outbreak of World War II. What goes on in the Communist areas of the world is less clear in detail, but equally clear in intention. We cannot, therefore, regard our present share of world seaborne carriage as a permanent amount. Can we hold it? And have we any chance of increasing it?

The answer to these questions depends on two groups of factors, one economic and one political, one on the whole favourable and one on the whole adverse. If the carriage of goods by sea is left to find its way under ordinary economic forces to those countries which can undertake it most cheaply and efficiently, the U.K. Mercantile Marine can hold its own. It is true that our costs have increased very greatly over the past ten years both in the operation and in the building of ships, but so have the costs of other nations; and although I cannot measure the relative increases with any exactitude I believe it to be true that there are now very few nations who can provide a comparable service to our own on cheaper terms. On the whole the effect of the war has been to improve our competitive position so far as concerns operating costs, though it has sadly depleted our capital equipment and resources.*

* Operating costs in 1948 were probably from 2½ to 3 times those of

Unfortunately it seems unlikely that governments will be content, or will be allowed by pressure groups of their own shipowning interests to rest content, to see the traffic going to the cheapest and most efficient producer. Considerations of cost are apt to be overridden by those of defence, employment policy and national prestige. In various countries there have already appeared direct measures of state assistance to shipping and a tendency to discriminate in favour of the national flag. Not all these developments are postwar novelties. Nor is this the first time in history that they have appeared—there were very similar movements after World War I, resulting in, among other things, some costly experiments which were later abandoned and in continual struggles by the major maritime nations to combat concealed discriminatory practices. But they are now with us once more in added strength. I will summarise briefly the principal measures of assistance to shipping or shipbuilding in the form of subsidy or taxation relief for some of the major maritime countries of the world.

Argentina. A law of September 1948 of general application to industry allows tax exemption on a high proportion of profits ploughed back into the business; for instance, there is an exemption of 80 per cent if more than 90 per cent of taxable profits are re-invested in shipping. Indirect assistance to Argentine ships is also provided in such matters as port dues, which are discriminatory against foreign ships.

Australia. The Australian Government has now entered the shipbuilding trade and has announced its intention of entering the ship-operating trade. In October 1948 the government agreed to sell postwar government-built tonnage at 25 per cent below cost price to make it competitive with U.K.-built tonnage. Whether operating subsidies will be given remains to be seen.

Belgium. A law of August 1948 provides a fund of 2,000 million francs (£11 millions) to be available at 300 million

1938. Present costs of bunker coals in the U.K. are 4 times the 1938 level, bunker oil over 2½ times, foreign disbursements of all kinds 2½ times and building costs about 3 times. The standard wages of an A.B. have increased to 2½ times the 1938 figure, but crew costs have increased a good deal more owing to reduced working hours, additional crew accommodation and other imponderable items of a like character.

francs per annum for loans (at low rates of interest) to Belgian shipowners towards the cost of new ships. The loans may cover up to 70 per cent of the building cost and the state may also guarantee the interest and capital on private loans.

Brazil. The merchant fleet, 80 per cent of which is state-owned, receives an operating subsidy.

Denmark. There are taxation provisions, extending to industry generally, under which the excess of current building prices over 1939 prices may be written off subject to a maximum of 50 per cent of the excess in any one year. This is additional to normal depreciation allowances.

France. There are operating subsidies to certain lines and building subsidies have also been provided.

India. Provision is being made for an operating subsidy by three new Indian lines, which are to be formed with the state owning 51 per cent of the capital. Apparently the subsidy is to be recovered from subsequent profits, if any.

Italy. The government has proposed a large differential shipbuilding subsidy. Long-term state loans may be available to owners for 40 per cent of the cost of a ship.

Norway. There are taxation reliefs similar to those in Denmark, and profits derived from the sale of ships are tax-free if eventually used for the purchase of a new ship.

Spain. It has been reported that an operating subsidy for Spanish lines is being considered.

Sweden. Companies may (as in Swedish businesses generally) write down their assets as fast as they like and are free of tax on money so used.

U.S.A. There are substantial building and operating subsidies, the latter being confined at present to vessels sailing on specified foreign routes. It has been reported that subsidies are under consideration for tramps.

This schedule of information may not be complete or fully up-to-date when this paper is read, but it is more than enough to establish the point that U.K. shipowners are having to face state-aided competition all over the world. Naturally they regret it. They recall that there are no operating subsidies on U.K. foreign-going vessels—and perhaps I ought to make it quite plain that the last thing they want in this country is an

operating or any other kind of subsidy. In common with U.K. industry generally, they have been granted some measure of tax amelioration by provisions under which 40 per cent of the cost of a new ship may be written off in the first year, though even here they are much less favourably treated than the Scandinavians. They complain with justice that they alone, of all shipowners in the world, are subject to the so-called 'balancing charge', which exacts tax on profits on the sale of ships in excess of the written-down value. And like most other branches of U.K. industry, they emphasise the difficulty of replacement at present building prices when so much of their profits is removed in taxation. It is not surprising that they feel hardly treated in comparison with shipowners of other countries.

It is nevertheless permissible for an observer, perhaps even for a shipowner, to take quite a favourable view of the future of U.K. shipping in world trade, at least as far as concerns operating subsidies. As freights decline—and there is general expectation that they will, though not perhaps catastrophically as after World War I—the burden of subsidisation tends to become greater if the subsidy effectively is to bridge the gap between earnings and expenses.* There comes a time when a government has to ask itself whether it can go on indefinitely paying large and increasing sums to maintain an insolvent branch of its economy. After the last war, Australia, Canada, France and the United States had to reply in the negative and either wholly or partly withdrew state assistance in the form of operating subsidies after incurring very heavy losses. Whether the existing state subsidies will survive a lean period of poor earnings remains to be seen. As long as they do continue they provide a handicap to the U.K. owner; but they are not necessarily here to stay.

One may also hope that internal taxation will not indefinitely continue on its present basis to impede the recapitalisation of the industry. At the present time there is more old and obsolescent tonnage on the U.K. register than we should like. Replacement hitherto has been governed mainly by the capacity of the yards, but there are signs that demand is slackening,

* British tramp freights in July 1949 were about 84 per cent. of those ruling in January 1949 and about 66 per cent. of those for January 1948.

and although there are few idle berths in U.K. yards the order books are not full. Building in the future will be more a matter of modernisation and replacement than of filling a gap created by war. High prices will be more of a deterrent and the owners' ability to find the money to replace will be more of a governing factor. It is greatly to be hoped that the financial conditions of the U.K. will permit the Government to relax the strain on the industry by allowing more profit to be ploughed back.

If this were all, the power of the U.K. mercantile marine to maintain its position, if not a matter for wild optimism, would at least not be one for desperate pessimism. But there are other and, in my view, more dangerous political tendencies abroad today which give rise to anxiety. The very fact that subsidies or other direct financial assistance to any industry are expensive and unreliable sometimes leads nations to forms of discrimination which are less easy to combat even if they cost them more in the long run. Discriminatory port charges are an example on a comparatively small scale. The compulsion or coercion of private merchants to use the ships of a particular flag regardless of cost is one of the most serious; and when government trading organisations adopt the principle of insisting on the carriage of their commodities in the national flag the principle of discrimination becomes the most dangerous of all.

It is necessary here to draw a distinction. In the present international monetary situation a government sometimes has to constrain its merchants to move its imports in the tonnage of its own or another relatively soft-currency country. Most European countries, for example, avoid dollar tonnage whenever possible, merely because of their shortage of dollars. The Spaniards have been avoiding British tonnage because of their shortage of sterling. To describe this situation as discriminatory is to force the meaning of the word; it is imposed by financial stringency and is not directly aimed at the exclusion of other countries' shipping from the national trade. All the same, it sometimes militates against the free movement of the carriage of goods to the cheapest and most efficient suppliers and creates artificial situations which are apt to linger after the primary reason for their appearance has lapsed.

Apart from financial reasons, however, there is a tendency to claim that a nation has, as a matter of common justice, the right to see half her trade moving in vessels under her own flag. This is a very plausible fallacy which was widely canvassed even before the war. It is now enshrined as part of the European Recovery Programme to the extent that half the Marshall Aid cargoes coming from the U.S.A. to Europe are to be carried in U.S.A. ships if they are available at market rates of freight. If Senator Bland had been successful with a Bill which he introduced early this year, the principle would have been applied to all U.S.A. Government-sponsored cargoes in futurity, wherever moving, to each type of vessel, liner, tramp and tanker separately and without regard to the rate of freight. It is doubtful whether this measure would have been to the advantage of the U.S.A. herself; it might well have been catastrophic in its effect on European tonnage. Even the comparatively mild measures which were finally accepted as a compromise are objectionable in principle.

It may seem rather ungrateful in American eyes for the European sharers of Marshall Aid to object to the 50 per cent rule. 'Surely,' the Americans may ask, 'if we are prepared to give enormous quantities of goods to help the recovery of Europe, we are entitled to attach to the gift a condition which protects our shipping from unemployment? Admittedly you may have to pay dollars in freight which you would prefer to spend on goods; but, after all, we are giving you the dollars. And we are sharing the carriage equally with you, not keeping it all for ourselves.' Put in this way the argument would seem to most people—certainly to most citizens of the U.S.A.—quite unanswerable.

Nevertheless there is an answer, and if the meeting will forgive my re-stating it in terms of kindergarten economics I will put it shortly. International trade between dollar and non-dollar areas is effectively bilateral; unless we are prepared to see the European countries become permanent pensioners of the U.S.A., or unless the flow of goods from America to Europe is to be regarded as capital investment, we can buy from the dollar areas only if they are willing to buy from us. Moreover, as they are so richly endowed with most raw materials they

must be willing to buy either our manufactures or our services. If they cut down their purchases of either, their own export trade will suffer. In short, if the volume of trade is to be fully maintained they must buy what we can cheaply produce; and in particular they must buy our shipping services which we, in common with most of the maritime countries of Europe, can produce more cheaply than the dollar areas. Few single measures would be so restrictive of foreign trade as a general application of the 50 per cent rule regardless of cost. It would be as sensible as prescribing that the United Kingdom must grow half her consumption of coffee, in state-supported greenhouses, because she has a natural right to produce half her own food and drink.

Types of shipping

Up to this point I have spoken of U.K. shipping as a whole without reference to the individual types of vessel and trade which form its constituent parts. To obtain a thorough appreciation of the position, however, it is necessary to go into somewhat greater detail. Merchant shipping vessels can be classified into three main groups—liners, tramps and tankers. The tanker class—to take the simplest one first—comprises vessels which specialise in the carriage of liquid products in bulk, mainly crude petroleum or its derivatives and some food products such as molasses and palm oil. These ships hardly ever carry passengers on any important scale and are not adaptable—or at any rate are not in practice adapted—for dry-cargo trades. Their future is bound up most intimately with the future of the petroleum industry. Tramps carry bulk cargoes (grain, ore, timber, fertilisers and coal) on voyage charters, and switch from one trade to another or from one area to another as the need arises. Their future depends largely on the international movement of bulky raw materials. They may carry a few passengers, but not usually very many. Liners, on the other hand, sail to a schedule in specified trades, and carry manufactured goods, passengers and occasionally some bulk products such as grain.

In the middle of 1948 about 21 per cent of our foreign-going tonnage was tanker, about 23 per cent tramp and about

56 per cent liner. Compared with the rest of the world the U.K. owned about 22 per cent of the world tanker fleet and (omitting laid-up U.S.A. ships) 26 per cent of the dry-cargo tonnage. What proportions of the world tramp tonnage and of the world liner tonnage we owned is not known exactly because of deficiencies in information for other countries as to how the fleets are divided between tramps and liners, but our share of the world tramp fleet was doubtless higher than of the world liner fleet.

A good deal of the effective increase in tonnage trading nowadays as compared with prewar is due to the expansion of tanker traffic, which is itself a reflection of the increase in the world output of oil. A world production of 272 million tons in 1938 had grown to 414 million by 1947 and to 471 million tons in 1948. The U.S.A. herself has become a net importer of oil. Tanker carryings from the Middle East have increased correspondingly and, even if projected pipe-lines to the Mediterranean are built, will increase further. Some interesting light on these important developments are given in the annual records of the Suez and Panama Canal Companies. In 1938 about 34.4 million *net* tons of shipping passed through the Suez Canal, about 17 per cent of it being tanker; in 1948 the corresponding figures were 55.1 million net tons of transits, no less than 60 per cent of which was tanker. Or to put it another way, by 1948 transits of dry-cargo ships had not regained the prewar level, whereas transits of tankers had increased fivefold. The Suez Canal Company is having to build a by-pass canal to cope with the new traffic.

On the other hand, tanker traffic through the Panama Canal seems to be declining. In 1928 29.5 million net tons passed through the canal, 21 per cent of it tanker. Ten years later the figures were 28.1 million tons and 12 per cent tankers. In 1948 there were 22.9 million tons and less than 10 per cent tankers.

The general demand for the carriage of oil by sea has led to extensive tanker-building programmes since World War II. The world total of tanker tonnage increased from 11.5 to 16 million gross tons between 1939 and 1949. The tonnages in

the ownerships of the main countries concerned are shown in Table 2.

TABLE 2. *Tanker tonnage by nationality,* 1939 *and* 1948
(Steam and Motor Vessels of 500 g.r.t. and over)

	Sept. 3, 1939 (000 g.r.t.)	Dec. 31, 1948 (000 g.r.t.)
United Kingdom	3,029	3,585
France	332	446
Holland	542	494
Italy	432	507
Norway	2,113	1,876
Panama	474	1,489
Sweden	163	346
U.S.A.	2,896	5,796
Other countries	1,585	1,471
Total	11,566	16,010

Apart from the U.S.A. (very little of whose tanker tonnage is laid up in reserve) and Panama (the registrations in which do not reflect true ownership) the pattern of ownership in 1948 was much the same as in 1939. Notwithstanding heavy war losses our own fleet was above the prewar level and on the increase. The speed with which we were able to reconstruct the tanker fleet in spite of very high building costs is doubtless due in part to the fact that about three-quarters of the U.K. tanker tonnage is owned by subsidiaries of the oil interests.

The tanker position thus gives little rise for anxiety. When a branch of an economy is expanding it can usually carry its troubles without much difficulty. There are, of course, always the general overriding anxieties of the future, the possibility of a serious slump, the strategic and political problems arising from the geographical location of the oil wells, the rising operating costs and so on. But on the whole there seem no grounds for dissatisfaction at the state or prospects of tanker

shipping or at the size of the share of the trade which will move under the U.K. flag.

The future of the dry-cargo trades provides a different problem. The employment of shipping depends almost entirely on the demand function and, in the conditions of the world as we have them today, it is exceedingly difficult to foresee to what level international trade will ultimately return; whether it will pursue a gently rising course as is to be hoped, or whether political and strategic circumstances will, as between the two world wars, tend to restrict it. Up to a few months ago, the postwar demand for shipping on the whole exceeded the supply and the freight market generally was good; but with fleets still on the increase it is natural to expect that the time is not far distant when there will be a surplus of tonnage, at least in certain areas, or for certain types of ship. You will not expect me, I hope, to say very much on this subject. It is more a matter for crystal-gazing than for statistical estimation. But it is so important that I cannot pass it over without some mention.

As concerns tramps, it has for very many years been a recognised feature of the tramp trade that the fluctuations in its earnings are more violent than for liners. A very small surplus of tonnage can exercise a very depressing effect on the freight market, and in times of slump, such as occurred in 1930-5, freights may remain at a low level for long periods. There are signs that the tonnage balance in the tramp market has been reached and that freights, which have been falling over the past few months, may continue to do so. We all hope that a recurrence of the great depression of the 'thirties will be avoided, but the problem is indeed difficult and one may fairly question whether it can be solved without some measure of international agreement.

The liners, of course, are also badly hit in times of depression, but their problem is somewhat different from that of tramps. In so far as they are organised into conferences serving particular areas their problem is to some extent localised and the basis of co-operation exists. On the other hand, they must on occasion face the necessity of running at a loss in order to maintain their services and their goodwill, whereas a

tramp vessel at the worst can always be laid up. The next ten years is clearly going to be a very testing time for shipping all over the world, and for none more than British shipping, because of its desire to rely on its own efforts and not to call upon state assistance.

Perhaps I should add a few words about competition from air carriage. It seems clear that for the great range of bulk and manufactured commodities, air transport is not a serious competitor to sea transport. A few years ago it was estimated that carriage by air was thirty times as expensive as carriage by sea, and although the ratio may have altered in the meantime it appears most probable that the disparity between costs will remain so great that the air will not make serious inroads on seaborne traffic. It does, of course, tend to skim the cream off that traffic by the transport of small but expensive articles and also in the carriage of passengers but, on the whole, I doubt whether any liner company regards air transport as a serious menace to its survival. On the contrary, so far as it speeds up communication between communities and makes commercial management easier it may assist not only itself but sea transport and the latter may gain in the long run.

Geographical distribution of British carrying trade

For many years a substantial part of our carrying trade has been between foreign countries. This traffic does not, of course, appear in our own trade returns, and in consequence a picture of our carrying trade throughout the world is not easy to construct in detail. Table 3 below gives an analysis of trade between the U.K., the Commonwealth group of countries (including Eire, India and Burma) and foreign countries for 1912 and 1936.

Thus, whereas in 1912 21.5 per cent of the goods carried in British ships were transported between foreign countries, the proportion had fallen to 14 per cent in 1936; and the proportion carried between Commonwealth and foreign countries had fallen from 51.5 per cent to 45 per cent in the same period. *Per contra,* the proportion carried within the Commonwealth rose from 27 to 41 per cent.

So far as concerns proportions by value of goods, the above

TABLE 3. *Geographical distribution of British carrying trade and earnings*

	of goods Proportion by value		Proportion by value of gross freight (excluding passenger fares and coasting freight)
	1912 %	1936 %	1936 %
Inter-commonwealth			
U C	23½	36	39
C C	3½	5	4
Commonwealth-Foreign			
U F	40	29½	27
C F	11½	15½	14
Foreign-Foreign	21½	14	16
Total:	100	100	100

table is based on U.K. official statistics with estimates derived from overseas trade returns. The last column, giving proportions by gross freight, is based on an *ad hoc* inquiry which the U.K. shipping industry carried out at the Government's request for the year 1936. No postwar figures of a similar kind are yet available. The industry has, however, recently carried out another inquiry into the contribution of U.K. shipping to invisible exports, and this throws some incidental light on the distribution of our carrying trade in 1947.

For the purposes of a broad analysis I divided the world into seven areas as follows:

0. United Kingdom.
1. America.
2. North Europe (France, the Baltic and Scandinavia).
3. Mediterranean (including Spain and Egypt).
4. Africa (other than Mediterranean).
5. Asia (including Malaya and Japan).
6. Oceania.

The following Table 4 shows the proportions of gross freights earned by U.K. shipping in 1947 (including tankers but excluding whalers and excluding passage money) (a) on voyages to and from the U.K. and (b) on cross voyages.

TABLE 4. *Geographical distribution of freight earnings of U.K. ships in* 1947

Area	(a) Voyages between U.K. and area named	(b) On cross voyages beginning or ending in areas named*	Total (a) and (b)
1. America	24.0	11.9	35.9
2. N. Europe	4.6	4.9	9.5
3. Mediterranean	6.2	4.6	10.8
4. Africa	7.0	2.2	9.2
5. Asia	9.6	10.9	20.5
6. Oceania	9.5	4.6	14.1
Total	60.9	39.1	100.0

* This item covers freight payable on discharge or on shipment in the area named, i.e., for cargo moving from area A to area B the freight was assigned to A if payable on shipment and to B if payable on discharge.

Although 1947 was not a representative year, some of the tonnage being still short and a number of passenger liners still being reconditioned after war service, the table illustrates the remarkable extent of the distribution of British shipping over the surface of the globe. It must be remembered that the distribution is one of freight earnings, not of the weight or value of cargo carried, so that longer hauls (e.g., from the U.K. to Oceania) which command higher freights are to that extent over-represented by reference to the actual amount of cargo moving. It is nevertheless clear that every area is important, both for the voyages to and from the U.K. and for the cross voyages.

Another interesting feature of Table 4 is that nearly 40 per

cent of the gross earnings are attributable to cross voyages, that is to say, to voyages outside the U.K. This may not be a permanent and representative proportion of the relative value of the cross traffic, because in 1947 a number of tramp trades to the U.K. were under freight control and, on the whole, freights in the cross traffic tended to be higher than those to and from this country. From Table 3 it can be seen that in 1936 the proportion of cross freights, on the gross freight basis, was 34 per cent (the total of the items for C-C, C-F, and F-F trades), from which it appears that the cross trades are as important in our total earnings now as in 1936 and may indeed be more important. From the point of view of the shipping contribution to our trade balance, they are even more important than appears on the face of statements based on gross freight, because all freights payable in the cross trades are earnings of foreign currency or of Commonwealth sterling, whereas freights on inward cargoes to the U.K. are in effect paid by U.K. citizens and contribute nothing to the balance of payments.

The object of this paper has been to give some idea of the place of the U.K. Mercantile Marine in international commerce, its position in comparison with that of the other maritime countries and the geographical distribution of its activities. I should have liked to conclude with some account of the relative importance of the fleets of the world in the economic life of their respective owning countries, for example, by comparing the contribution of those fleets to the balance of payments.

I am unable to give any figures for the postwar period, but a few years ago Mr. J. S. Smith of the U.S. Department of Commerce made for certain inter-war years some interesting comparisons between the shipping receipts, the national income and the visible exports of the major maritime countries. Table 5 is based on Mr. Smith's estimates.

The figures in column 4 are approximate and are based on the assumption that the net exchange receipts are one-third of the gross earnings, the other two-thirds being attributable to disbursements such as port expenditure at home and abroad. Nor do they represent a net earning of foreign exchange, be-

TABLE 5. *Merchandise exports and shipping receipts for certain countries in* 1937 *(millions of national currencies)*

(1) Country	(2) Monetary unit	(3) Value of exports of domestic products	(4) Approximate net exchange receipts from national mercantile marine	(5) Ratio, col. (4) to col. (3) %
United Kingdom	pound	521	70	13.4
Denmark	crown	1,569	111	7.1
France	franc	23,939	967	4.0
Germany	reichsmark	5,911	220	3.7
Greece	U.S. dollar	87	21	24.1
Holland	florin	1,148	106	9.2
Japan	yen	3,132	146	4.7
Norway	crown	811	296	36.5
Sweden	crown	2,000	118	5.9
U.S.A.	dollar	3,299	63	1.9

cause, among other things, freight on imports carried in the ships of the importing country is regarded as payable by the nationals of the importing country. The figures do, however, provide some sort of general picture of the relationship of shipping earnings to visible exports for the specified countries. The relative importance of the shipping industry in Norway, Greece and the U.K. is very noticeable. It has been enhanced by the war; and if, as we may hope, the U.K. marine maintains its place among the fleets of the world it will in future make even greater contributions than in the past to the all-important gap between our visible imports and our visible exports.

The Organisation and Functioning of British Insurance

By

SIR PHILIP D'AMBRUMENIL
(Member of the Committee of Lloyd's)

INSURANCE is one of the main pillars upon which the material prosperity of the community depends.

The function of insurers is to provide protection so that a trader may be able to carry on his normal avocation without fear of the hazard outside his control in the shape of, say, a shipwreck or a conflagration. If he could not protect himself against a loss arising from an outside event there could be no doubt that his activities would have to be curtailed with consequent loss to the commerce of the country. If the insurer is to fulfil his proper function and thereby foster the trade of the world he must be properly organised in order to be able to carry out this role.

This brings me to the subject matter of my talk today, namely, *The Organisation and Functioning of British Insurance,* and in the main what I have to say on this subject will be confined to marine insurance.

British insurance differs from that of other countries in that there are two separate classes of insurer—the insurance company and Lloyd's. An insurance company—the capital of which has been subscribed by shareholders who have only a limited liability—is a corporate body functioning in its corporate capacity. On the other hand Lloyd's underwriters trade as individuals with unlimited liability and each for himself and not one for the other. Over the years it has become the practice for underwriting members of Lloyd's to group themselves into syndicates (under the control of an active

underwriter), each 'name' in a syndicate being a participant in a stated ratio. In effect, a Lloyd's syndicate does not differ materially from an insurance company, although its methods of operation may vary.

Each Insurance Company and each syndicate has an active underwriter who accepts or rejects the business offered to him, the difference being that in the one case it is the company which is liable and in the other it is the 'name' who is personally liable for his own participation.

In judging the organisation of British insurance one is bound to take notice of these two separate insurance markets, for one has acted as a spur to the other. It might be said that the organisation of an insurance company is a much more controlled one than a syndicate of Lloyd's underwriters. In the former a board of directors, through the general manager, will control within certain limits the activities of the underwriter; in the latter the underwriter is often carrying out the functions of the board of directors and the general manager.

Marine insurance has always been a highly individual business, that is to say, the rating of risks on the whole is not governed by tariffs, but is according to the judgment of each individual underwriter. It may be asked why the practice of marine insurance differs so widely from that of other classes of insurance; the answer is that the hazards do not lend themselves to general rating in the same manner as, say, a fire risk on a private dwelling.

There are certain broad principles which must be maintained in every form of trade, and although marine insurance may be highly competitive in its rating, insurers must provide certain facilities not only for their own protection, but also for the protection of the insuring public.

Perhaps the first consideration is the financial security offered by the insurer, for without this an assured could find himself in the position of having effected a policy of insurance and yet be unable to recover the amount of his loss.

The British insurance companies justly enjoy a very high reputation in this respect, and the strength of their position can always be obtained from their published balance sheets. Furthermore, the Assurance Companies Act of 1946 lays

down a minimum solvency standard below which no company is permitted to continue to trade.

In the case of Lloyd's underwriters no balance sheets have hitherto been published, although under the Assurance Companies Act of 1946 an Annual Statement of Income and Outgoings commencing from January 1, 1948, will be published. Lloyd's underwriters, however, have to provide security and show a financial standard which is second to none.

Before any person is elected an underwriting member of Lloyd's he has to produce a Certificate of Means certified by a banker, solicitor or accountant, and unless he can show a certain minimum standard he cannot be elected. Before he is allowed to commence underwriting he has to deposit with the Committee of Lloyd's, and in their name, a certain sum which, except in certain special events, cannot be treated as an asset. All his premiums have to be paid into a trust fund, and no money can be withdrawn from this fund in the shape of profits until the end of year 3 in respect of the operations of year 1.

Each underwriter has to submit himself annually to what is known at Lloyd's as 'The Audit', but this word gives no indication of its severity. The Audit is, in fact, a test of solvency and, broadly, an underwriter must show that at the end of each year he has sufficient assets in his trust fund to meet his liabilities exclusive of his deposit and personal wealth. If he does not have these assets according to the tests applied, then he must find the necessary deficiency from his outside resources or cease underwriting. If in fact he should become insolvent then the deposit is used, and, if this be insufficient, the Central Guarantee Fund has to make good the deficiency. There has been no case of default of a Lloyd's underwriter to the insuring public for a great number of years, and not one since all the present stringent regulations have been in force.

The standards laid down are in excess of the requirements of the Assurance Companies Act, 1946.

Having dealt with the financial side of British insurance, I now come to the various organisations which exist for the proper and orderly conduct of the business.

THE COMMITTEE OF LLOYD'S

This Committee consists of twelve members, each of whom is elected for a period of four years. At the end of this period each such member must stand down for a period of one year before seeking re-election. *Inter alia,* the Committee lay down all the rules as to the deposits required to be found by members and which in amount vary according to the premium income of each underwriter. In addition, it is responsible for the affairs of the Corporation of Lloyd's.

I will now mention some of the services performed by the Corporation of Lloyd's.

Shipping Intelligence

Although started by the underwriting community for their own benefit, this has grown into a widespread organisation. It is possible immediately to ascertain the latest movements of every seagoing ship. Daily the arrival and departure of every vessel is published under port headings, the information being supplied by Lloyd's agents from all parts of the world. It can be realised the inestimable value of this service, not only to insurers but to the public at large, any one of whom may be interested either for family or trade reasons in knowing the latest whereabouts of a particular vessel.

Lloyd's Agents

The name 'Lloyd's Agent' is known throughout the world. Each agent is carefully chosen by an Agency Committee consisting of underwriters at Lloyd's and of insurance companies. His duties are varied in character, but apart from the supply of shipping information his chief duty is to survey damages and to settle claims under the system of 'Payable Abroad Policies' which have been moulded to meet the needs of the insuring public.

A merchant may be selling goods on a c.i.f. basis to a consignee in the Argentine. The goods arrive damaged and it is obviously an inconvenience to the consignee that he should have to forward all the documents to the consignor, who in turn would have to collect from underwriters before the re-

mittance could be made to the consignee. To overcome this the 'Payable Abroad' system has been adopted. Such a policy of insurance contains a clause to the effect that in the event of a claim the amount due from underwriters will be paid by the agents in the country of destination. Lloyd's agent draws on the Committee of Lloyd's and in turn it is reimbursed by the underwriters who have insured the particular goods.

The insurance companies also use the services of Lloyd's agents, although in recent years the practice has grown for them to appoint their own agents. Whether this service is performed by Lloyd's agents or by a company's settling agent, the method of operation is similar.

Average and Recoveries Department

This Department also plays its part in the organisation, and it is interesting to note its small beginning. In response to representations which had been made to them, the Committee of Lloyd's set up a small office in 1874 which was announced at that time as 'for affording Underwriters facilities for intercommunication'. The office also ascertained the underwriters who were concerned in casualties or damage reported by Lloyd's agents, or requests from Lloyd's agents for instructions in any particular case, and so formed the necessary link between the Lloyd's agent abroad and the interested underwriters. From this small beginning the department has grown and its functions have been very widely developed.

From communicating to underwriters the information received from various sources and sending out instructions on their behalf it was a very short step to the department making other arrangements to take care of the interests of underwriters as a whole, and today among its activities through the Recoveries Department it examines and checks average adjustments and recovers moneys for underwriters when underwriters are due for refunds under such adjustments.

This department acts for Lloyd's underwriters, insurance companies and others in the collection of refunds and recoveries of the following descriptions:

(1) General Average and Salvage—

(*a*) Refunds of Deposits,

(*b*) Allowances in General Average in respect of Loss of and/or Damage to Cargo,
(*c*) Salvage Proceeds;

(2) Collision Recoveries;
(3) Recoveries from Carriers under the Carriage of Goods by Sea Act, 1924, and other similar legislation.

SALVAGE ASSOCIATIONS

The most important of these is The Salvage Association, incorporated in 1867 by Royal Charter as 'The Association for the Protection of Commercial Interests as respects Wreck and Damaged Property'. This latter title aptly describes its functions, which are undertaken on a non-profit basis. It is interesting to note that in the First Annual Report of the Association, dated July 7, 1857, there is a paragraph which reads:

'It had long been felt that some Institution was needed as a means of ascertaining the cause of the undue increase of losses arising from damage to ships and cargoes and of finding, as far as practicable, a remedy for such a state of things to insurers alike and every fair trader, whether Merchant, Shipowner or Underwriter.'

The whole of the Association's activities are controlled from the London office, but there are surveyors and agents all over the world.

When underwriters learn of a casualty they instruct the Salvage Association, who instruct their surveyors as may be necessary. This is done in co-operation with shipowners or other parties concerned.

The work may be divided into four broad classes: (i) salvage, (ii) repairs to ships, (iii) dealing with damaged cargo, (iv) miscellaneous matters.

When salvage has been concluded the ship has to be repaired. In addition to repairs following salvage, almost every ship at some period requires repairs through the various casualties which arise in the course of her existence. Repairs, therefore, are more general in their incidence, and it is with the repair of ships that a large bulk of the Association's work is concerned.

The Association, through a network of surveyors both at

home and abroad and in co-operation with owners, surveys the vessels and separates the damages caused by accident from those arising from wear and tear, agrees the place of repair, and checks the cost of the work done and the basis on which it is to be carried out.

Cargo Salvage. The Association's functions in regard to cargo salvage are similar to those in regard to ships, although the perishable nature of many cargoes necessitates some difference of procedure.

The Salvage Association as such owns no salvage vessels, but through its close ties with the salvage companies is able to make the most expeditious arrangements for the saving of property.

There is also the Liverpool and Glasgow Salvage Association, which was originally two separate bodies but amalgamated in 1923. Although in its formation this Association was similar to the Salvage Association, its development has been on different lines, the former developing a practical side, both with regard to salvage operations and the physical dealing with cargoes and the latter confining itself to supervisory, consultative and controlling functions. The Salvage Association and the Liverpool and Glasgow Salvage Association work in close harmony.

If the argument were ever advanced that these Associations confer no benefit upon the general community but only a benefit to the underwriter, it would not hold water. For instance, during the first and second world wars these Associations played an inestimable part in reducing to the minimum the loss of damaged cargoes and ships.

UNDERWRITING ASSOCIATIONS

The best known and most important of these is the Institute of London Underwriters. This was formed by the principal marine insurance companies for the advancement of marine insurance and the protection of the interests of marine underwriters by consultation and united action. Its Certificate of Incorporation was issued in 1884. One of its functions is the framing and revision of standard clauses.

It must be appreciated that the marine insurance policy

form is one couched in somewhat archaic language and does not in itself provide all the necessary cover required under modern-day conditions. The practice has therefore grown up of attaching additional standard clauses to the policy of insurance so as to extend the coverage and clearly define the beginning and end of the venture. These standard clauses framed by the Technical and Clauses Sub-Committee do not, other than in exceptional circumstances, need amendment in order to give proper protection to an assured.

Lloyd's Underwriters' Association

Most of the underwriting members of Lloyd's who transact marine business are members of Lloyd's Underwriters' Association. This Association deals with all matters of general interest to marine underwriters at Lloyd's, acting in a similar capacity as does the Institute of London Underwriters for the marine insurance companies. As there are many matters which are of interest to both companies and Lloyd's there are a number of joint committees consisting of members of the Institute and Lloyd's Underwriters' Association.

Liverpool Underwriters' Association

This Association works closely with the Institute of London Underwriters in all marine insurance matters.

ASSOCIATION OF AVERAGE ADJUSTERS

In the early days of the nineteenth century underwriters at Lloyd's found it necessary to obtain outside assistance in formulating and checking claims against policies of marine insurance. With a view to securing uniformity of practice, an Association of Average Adjusters was formed in 1872. A candidate who wishes to be a member of the Association has to fulfil certain requirements as to service under a qualified adjuster, and pass preliminary and final examinations. The process of adjustment calls for an expert knowledge of the law and practice relating to the subjects of marine insurance, general average and the contract of carriage by sea, and also the ability to apply correctly the principles involved in the circumstances of the particular case.

LLOYD'S REGISTER OF SHIPPING

This takes its rise, like the parent Institution of Lloyd's, in the Coffee House which was started by Edward Lloyd in the reign of Charles II. 'Ships Lists' appear to have been kept for their own guidance by the frequenters of Lloyd's Coffee House. These lists, which were written by hand, contained an account of vessels which the underwriters who met there were likely to have offered them for insurance. They were doubtless in the first instance, and probably for some time afterwards, passed from hand to hand much in the same way as the written news letters of the period, and were finally circulated for the use of subscribers.

Today Lloyd's Register is a voluntary association of underwriters, shipowners and others which exists for the purpose of certifying and classifying the shipping of the world. The whole of its revenue is devoted to the interests of shipping, in extending its staff of surveyors and perfecting its organisation. The symbol '100 A1' is a common expression of the English language which takes its origin from the symbol representing the highest class of Lloyd's Register.

WAR RISKS INSURANCE

In addition to marine insurance the market has always operated transit war risk coverage, both in times of peace and war.

Shortly before the commencement of the second world war steps were taken by the insurance markets of the world to exclude land war risks from all forms of insurance coverage, therefore the standard marine war risks clauses were amended so as to define the duration of insurance.

Broadly, cover is provided from the time the goods are on the ocean-going vessel until discharge at destination. There are certain limitations in respect of transhipped cargo.

Hulls of vessels for which there is no government scheme are also insured, but in these cases the practice is to give insurance only for a period of three months or a stated voyage.

I have endeavoured to give you an outline of the various bodies and associations which contribute to the organisation of British marine insurance. If marine insurers had never per-

formed any other function than the founding of these various associations and bodies I think it could still be claimed that without marine insurance great benefits would have been lost to the community.

FUNCTIONING

The functioning of marine insurance is in large measure peculiar to this country and has undoubtedly grown up as the result of the manner in which marine insurance was first conducted here.

As you must all be aware, Lloyd's Coffee House, from which Lloyd's takes its name, was a meeting place of shipowners and merchants. A shipowner or a merchant would wish to share his liabilities with others of his fraternity, which in the first instance was solely on a mutual basis. From this 'Coffee House stage' there grew the professional underwriter who, for a consideration in the shape of a premium, would undertake maritime hazards.

In the days of the Coffee House, the shipowner, merchant and underwriter could meet together, but as the business grew there emerged the broker, who acted as the liaison between the insured and the insurer. Today it is true to say that by far the greater volume of the business of marine insurance is handled through the medium of the broker. So far as Lloyd's is concerned, the fundamental rules of the Society do not permit of an underwriter accepting any business other than through the medium of a broker. The insurance companies, on the other hand, will and do accept business directly from the insured.

In order that you may properly understand the functioning of British insurance I would ask you to suppose that one of you is a merchant or shipowner, another an underwriter, and another a broker.

The merchant is anxious to insure some goods. He will give instructions to his broker, who will place the insurance with various underwriters, after which he will send a cover note to the merchant. In due course a policy is prepared.

Although this sounds quite simple, there is an infinite amount of work which has to be performed, and both broker and underwriter have so organised themselves as to be able to

cope with this daily routine. The broker, upon receiving his order, prepares what is known as a 'slip' which gives brief particulars of the insurance required. The underwriter places his initial on the slip, together with the line he accepts.

In due course policies are prepared. In the case of Lloyd's underwriters this service is performed by the brokers and in the case of insurance companies by the company from particulars supplied by the broker.

In the above instance I have given you a simple example of a single shipment of goods, but it will be appreciated by all that many merchants could not carry on their business if in the case of every shipment they had to give separate instructions for insurance. Therefore for cargo insurance a system of 'open covers' is in vogue. On the instructions of the merchant an open cover is effected, generally for twelve months and always open to take all his shipments up to a certain stated limit. In this manner the merchant has protection without the necessity of having to assure himself beforehand that he has taken the necessary steps to insure each shipment. The merchant will advise his broker monthly or at some other appropriate interval of the shipments which have been made and in due course he will be debited with the premium and a policy will be prepared, either for each shipment separately or in bulk according to his wishes.

The insurance of vessels is generally placed on the basis of each fleet separately and as each vessel comes on risk the same procedure of debiting and preparing a policy takes place.

The production of policies is now highly organised, and it is fitting that I should give you a brief outline of the procedure adopted.

In the case of a Lloyd's policy, which I have already told you is prepared by the broker, the broker at the same time prepares what is known as a 'bureau slip', which he forwards to the Signing Bureau together with the original slip. The various clauses and wordings attached to or written into the body of the policy are checked by an expert team of checkers to see that they are correct. After this has been done the bureau slip prepared by the broker, which contains the line and the syndicate number of the underwriter, is used for a variety of

purposes, and finally a separate card is produced for each underwriter for each insurance. This card contains abbreviated particulars of the policy which has been signed and in addition shows the total amount of premium he is due to receive from the broker.

You may know that there is an attachment to a Lloyd's policy of all the syndicates operating at Lloyd's showing the names of each underwriter in a syndicate and their proportion. It will be readily realised that it is seldom, if ever, that all syndicates of Lloyd's will be interested in the same single insurance. There is, therefore, attached to the inside of the policy a list of the syndicate numbers interested in a particular insurance, together with the amount.

In the case of insurance companies, the broker prepares particulars to enable the Companies' Policy Bureau to issue the policy, but when there are a number of companies interested in the same insurance there is still only one policy issued. This policy contains the names of all the companies interested and their participation. A similar bureau to that of Lloyd's carries out this function.

REINSURANCE

I have already explained that a merchant can deal with an insurance company direct. In that event he would generally expect that one insurance company would assume the whole liability, and it rests with the company to make reinsurance arrangements with his brother underwriters. It must be obvious to you all that if an underwriter is to be successful he must take steps to see that his risks are properly spread and that he does not carry a liability on any single vessel out of proportion to his premium income.

Such reinsurances may be arranged in a variety of ways. They may be on the basis of excess of a certain retention by the ceding underwriter, such retentions differing according to the type of vessels carrying the goods. Another method may be on the basis of excess of loss, in which event the premium is on a percentage of the total premium income of the ceding underwriter in respect of a particular class of insurance. Another method is what is known as 'Facultative', that is, a reinsurance of a specific named risk.

As a general principle, Lloyd's underwriters, who I have already explained only deal through the medium of brokers, do not have the necessity of entering into reinsurance contracts to the same extent as the insurance companies.

In my opening I said that I was confining my remarks mainly to marine insurance, but the subject matter of my talk is *The Organisation and Functioning of British Insurance.*

In the main, the insurance companies play a much bigger part in these other classes of insurance than Lloyd's. This is understandable when you realise that Lloyd's was originally solely a marine insurance community and it was only at the beginning of this century that the non-marine business began to develop there.

In consequence, this business is not in the hands of brokers to the same extent as marine. The British companies have always been highly organised, but their development has been by direct contact with the insuring public through the medium of branch offices and agents. Their activities are spread all over the world and they have been able to so organise themselves as to be able to cope successfully with the problems in every branch of insurance.

With the growth of the non-marine market at Lloyd's the broker today is playing a more considerable part than he did in the past, and when considering the general organisation and functioning of British insurance heed must be taken of this.

Some may argue that the broker should not play a too active part in the organisation and functioning, but in my view he is playing a very great part in the development of insurance. In the British insurance market the broker is probably a more active part of the organisation than in any other market of the world.

The various associations which play their part in the organisation and functioning of marine insurance have their counterpart in the various bodies which exist in other classes of business, for instance, the Fire Offices Committee, Accident Offices Committee, etc. They perform similar duties to those I outlined when dealing with the Institute of London Underwriters, but they take a more active part in general rating than the various marine associations.

BRITISH INSURANCE ASSOCIATION

This Association was formed for the protection, promotion and advancement of the common interests of all classes of insurance business. Close and friendly relations exist between the various government departments, and on questions of legislation it is the practice of the Association to place its experience at the disposal of the appropriate departments.

The governing body of the Association is the General Purposes Committee, which consists of the Chairman and Deputy Chairman of the B.I.A. and representatives of the Fire Offices' Committee, Life Offices' Association and the Associated Scottish Life Offices, Industrial Life Offices' Association, Accident Offices' Association, Institute of London Underwriters and the Liverpool Underwriters' Association, Engineering Offices' Association and members of the Association transacting fire or accident business who are not members of the Fire Offices' Committee or the Accident Offices Association.

This Association acts in a similar capacity as does the Committee of Lloyd's for Lloyd's underwriters. The two bodies work closely together on all matters to the benefit of the insurance community as a whole.

In conclusion, I would say without fear of contradiction that British insurance will always fulfil its role, its organisation will keep pace with the march of time and it will be flexible according to the conditions it has to meet.

The Treasury, the Budget, Public Debt, and Their Effect on the Monetary Situation

By

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HALF a century ago the budget and the currency were two wholly separate branches of policy. The supply of currency was determined by the supply of gold. The world's growing requirements of currency were met, partly by so much of the output of gold from the mines as was not absorbed by the demand for gold as a material of industry; partly by development of the use of bank credit as a means of payment.

Monetary policy was embodied in the measures relating to coinage and to banking. Coinage was merely the process by which the precious metals were made available in little ingots of certified fine metal contents, suitable for passage from hand to hand in the purchase of goods and services. Banking measures were chiefly concerned with preventing the creation of bank credit from outstripping its due proportion to the supply of coin.

A rigorous conformity to these principles was not invariably possible. Even in quiet times the mechanism for limiting the creation of bank credit worked imperfectly, and from time to time an over-extension of credit led to a financial crisis. More serious was the breakdown that was apt to occur under the stress of war. A country which could not meet the cost of carrying on a war from its tax revenue, and from loans subscribed out of current savings, would raise the necessary funds from bank advances. The limitations on the creation of bank

credit would be thrown to the winds; if the expansion of bank credit called for a supply of currency in excess of what adherence to the metallic standard would allow, paper currency would be issued to make up the deficiency. In other words, government expenditure was met by means of inflation.

Thus the exigencies of the budget intruded on the domain of monetary policy. This occurred in many countries during the Napoleonic wars, and their efforts to return to a metallic currency were felt in a deflationary tendency for a whole generation following 1815.

The wars of the period 1854 to 1871 produced much the same after-effects.

The world war of 1914-18 became the occasion of a more serious inflation than had ever been known before, and there resulted a deep seated change in our attitude towards monetary problems. The use of standard coin of gold as a hand-to-hand medium of payment ceased; coin (except subsidiary coin) was completely superseded by paper currency. Even while the gold standard was observed, and gold reserves had to be held against paper issues, the relation between the supply of currency and the supply of gold had become less direct. The widened discretion in the supply of currency imposed an increased responsibility on the public authorities responsible for it.

The established practice of devolving the arrangements of currency and banking on an independent central bank, with no other policy than adherence to a gold standard, was found wanting. The limits imposed by the gold standard upon expansion or contraction of the flow of money had become too wide. Even in the nineteenth century the limits had been wide enough to allow of an expansion or contraction of the national income by some 20 per cent, with very undesirable consequences, but now 20 per cent was far exceeded. The contraction of the income of the United States in the three years ensuing upon the crisis of 1929 exceeded 50 per cent.

A state of things that led to the new deal in America, to the abandonment not only of the gold standard but of free-trade in Great Britain and to the advent of Hitler in Germany, could

not be regarded as the exclusive concern of committees of bankers of conservative tendencies and limited outlook.

And the tendency for governments to supersede central banks in the control of monetary policy was reinforced by the abandonment of the gold standard. The abandonment of the gold standard does not dispense with a monetary reserve. But when the monetary reserve is no longer linked to the money unit by a gold par, the holding of the reserve involves an exchange risk, which is likely to be more than the capital and surplus of a commercially constituted bank can sustain. When the government takes over the monetary reserve in the form of an exchange fund or exchange equalisation account, it is really assuming direct charge of monetary policy.

A government would not necessarily adopt a different monetary policy from a central bank. The gold standard system by which the Bank of England and other countries shaped their policy had been imposed by legislation, and commanded the unquestioning approval both of the public and of governments. But the experience of the first World War and of the years that followed had not only destroyed the sacrosanctity of the gold standard, but had made inflationary government finance respectable. In this century of cataclysms the most prudent of governments was liable to be driven to pay its way by a creation of credit. The power to do so, even though only as a last resort, was not to be parted with on any account, and an independent central bank could not be allowed to stand in the way of its exercise.

But even the limitation of the creation of credit to a last resort was questioned. Inflation expands employment, and deflation contracts it. A government could stimulate employment merely by incurring a deficit and financing it by what had formerly been reckoned 'unsound' practices.

So long as governments held the balancing of their budgets to be a bounden duty, and kept their indebtedness to the banks within narrow limits, monetary expansions and contractions were brought about by increases and decreases of advances to traders. When expansion was followed by contraction, the depression and unemployment which resulted were accepted as an act of God beyond human control.

The inflation which ensued upon the first World War was seen to be the result of excessive government expenditure, and the essential condition of stopping it was recognised to be the balancing of the budget. A government which had created money by borrowing could extinguish money by repaying indebtedness. The vast floating debts inherited from the war involved credit transactions compared with which those of traders were almost insignificant. It was no use applying to the government the deterrent measures, such as high charges, by which banks were accustomed to keep advances to traders within limits. The government could not go short of the means of payment; it had to raise funds, and would, if need be, find means of overriding any resistance on the part of the banks. To achieve a deflation, the primary requisite was to reduce the government's own *need* of bank advances—to raise additional revenue and to effect economies in its expenditure. That once secured, measures for maintaining control over the creation of credit and currency would become possible.

The unprecedented depression which followed the American Stock Exchange crisis of 1929 cast doubts on the wisdom of the traditional practices. The gold standard had been restored, and the central banks had resumed control, but the monetary affairs of the world had become involved in a worse disorder than ever. Economic opinion turned towards what seemed to be the only alternative. If cheap money and relaxation of credit failed to evoke revival, might not a dose of the deficitary government expenditure, which had caused only too much inflation of the demand for goods after the first World War, reverse the fatal progress of deflation in the nineteen-thirties?

This doctrine made the relation between monetary policy and budget policy still more intimate. It pointed even to a system of monetary regulation through budget deficits and surpluses. The creation of money through a deficit would correct a deficiency of demand; a surplus could be employed to extinguish money and correct an excess of demand.

The New Deal in the United States included a plan of stimulating demand by deficits. It cannot be reckoned a success. In 1933 the number of unemployed is estimated to have

been 12,830,000. By 1937 real progress had been made, and the number had been reduced to 7,700,000. But even that, by the standard of past depressions, was an enormous figure. And in 1938 there was a relapse, the number reaching 10,390,000. As the average hours worked had fallen from 38.1 a week in 1933 to 35.6 in 1938, six years' deficits, amounting to $20,000 millions, had on balance achieved hardly any progress towards full employment.

Only in Germany was unemployment successfully quelled. There the cost of rearmament had risen by 1938 to something like one-fifth of the national income, whereas the deficit in the United States never exceeded 8 per cent (1935-6) and was usually 5 per cent or less.

It is not to be inferred from this experience that the resort to a budget deficit to stimulate employment is fallacious, unless the deficit is on the German scale. The flow of money in the United States was very greatly stimulated, the national income having risen from $39,600 millions in 1933 to $67,400 millions in 1938. But there had been a rise of wages from an average of 44.2 cents per hour (in manufacturing) to 62.7. The increase in employment was far less than in proportion to the increase in incomes.

In Germany on the other hand wages were controlled, and the rise in the national income from 45,200 millions of marks in 1932 to 82,100 in 1938 was mainly taken out in increased employment.

In both the United States and Great Britain war expenditure soon eliminated unemployment, and they had to deal with the contrary danger of inflation. The financial strain of the war was such that the creation of money by inflationary bank advances was inevitable. Both countries made a real effort to raise taxation to the highest practicable level—perhaps beyond it, since some overburdened taxpayers were undoubtedly driven to draw on their capital. But the deficit to be covered by borrowing far transcended any savings that could be expected from voluntary effort, with all the stimulation that persuasion and appeals to patriotism and prudence could supply.

Both countries had recourse to controls. Inflation is caused

by excessive spending, spending, that is, in excess of income. Income is equal to production, so that spending in excess of income is spending in excess of production, and can only be met from stocks of goods. When orders given for the replenishment of stocks begin to overstrain productive capacity, the natural reaction is to raise prices in order to check demand. The rise of prices increases the income of producers and their spending makes a further increase in demand. A vicious circle of rising incomes and rising outlays is set going.

The control of prices, if successfully enforced, puts a check to this process. The national income is equal to the production of goods and services, valued at the prices they obtain. Production is limited to capacity, and the national income is limited to production valued at controlled prices.

And spending is limited too. People can only buy what is produced or imported, and if, after they have bought what is offered, they still have money in hand, that money remains unspent.

There is a tendency for stocks of goods to be exhausted. The supplies of essentials are preserved by rationing, but other things become from time to time unprocurable.

Both incomes and outlays are kept within limits, but outlays within narrower limits than incomes, for incomes continue to be swollen by inflationary government expenditure. Consequently there is a progressive accumulation of idle money. That occurred in both Great Britain and the United States during the war, so that they finished up with enormous accumulations of idle money.

This redundant money constituted suppressed or potential inflation, all the more dangerous because heavy and insistent arrears of spending had been accumulating. It would not be easy by the floating of loans to extract money from people who urgently needed it to effect overdue repairs and renewals of neglected plant and property, and to replenish depleted stocks.

Great Britain and the United States were both faced with the problem of preventing this potential inflation from becoming actual. Great Britain has continued to rely on controls, especially price controls. The United States on the other hand

abandoned controls in June 1946, and was left without any defence at all against active inflation.

Inflation had been at work before the United States became involved in the war. The wholesale price index (100 in 1926) rose from 78.6 in 1940 to 94 in December 1941. Controls did not prevent it from rising further to 112.9 in June 1946. The removal of controls was followed by a steady rise, which carried the index to a maximum of 169.5 in August 1948. Average hourly earnings in manufacturing industry, which had risen from 66.1 cents in 1940 to 108.4 in June 1946, advanced to 137.2 cents in November 1948 and 138.0 in January 1949. Thus since 1940 both prices and wages had more than doubled.

In 1940 there were 8,120,000 unemployed, in 1948 only 2,004,000. Consequently the rise in prices and wages meant a more than proportional rise in the national income. The following table compares the rise in all three with the rise in the supply of money:

	1940	1948	Increase per cent
Price index . .	78.6	165.1	110.0
Hourly earnings .	66.1	132.7	100.7
National income (thousands of millions)	81.3	224.0	173.0
Money (demand deposits *plus* currency—thousands of millions)	42.2	110.6	162.0

It would seem that inflation has reached the limit at which the value of the dollar has fallen so far that the flow of money has caught up with the enlarged stock of money. The marked recession in activity which has been felt in the present year supports that inference. Nevertheless it is not yet certain that there will not be a recrudescence of inflation. The comparison

with the stock of money in 1940 is not altogether reliable. That year was still under the influence of the depression which had started ten years before, and a well-recognised characteristic of depression is that the stock of money becomes high relatively to the national income. In 1929 the national income was higher than in 1940, yet the stock of money was only $26,400 millions, or 62 per cent of the $42,200 millions of 1940. The stock of money was 30 per cent of the national income in 1929, 52 per cent in 1940, 49.4 per cent in 1948. By the standard of 1929 a stock of money of 30 per cent of the national income or $67,200 millions should have sufficed in 1948. That calculation, marking over $40,000 millions as redundant, cannot be taken at its face value. Habits may have changed in nineteen years. The high interest rates (short-term and long-term) prevailing in 1929 would induce people to keep idle balances down to a minimum. Moreover, if time deposits be included in the calculation, the ratio of money to national income was 62.5 in 1929, 86.1 in 1940 and 75.0 in 1948. The comparison with 1929 would make the redundant money no more than $28,000 millions.

It is by no means certain that any balance of redundant money remains. But even so, there is the possibility, under existing conditions of low interest rates, that there may be an indefinite further expansion of money. However that may be, the progress of inflation has quite evidently been suspended for some months. How far has the budget contributed to that result? There was a big redemption of debt in 1946, amounting to $19,200 millions, but this was not effected out of revenue. It was a mere book-keeping transaction, arising out of reduction of government balances from $24,600 millions to $3,100 millions. Over the whole three years from December 1945 to December 1948, though the gross reduction of debt was $25,900 millions, the reduction of balances was $22,500 millions. Consequently the reduction of debt out of revenue was only $3,400 millions. That was the margin available after providing no less than $15,400 millions out of revenue in the three years by way of aid to foreign countries. A notable financial achievement. But what concerns our present purpose is that this margin made no considerable contribution towards

extinguishing the redundant money. Indeed, a substantial expansion of bank loans to customers raised deposits (exclusive of government deposits) from $124,400 millions at the end of 1945 to $142,100 millions at the end of 1948.

Great Britain has retained the wartime controls, but they have not proved in themselves an adequate safeguard against the potential inflation becoming actual. In particular there has been no direct control of wages. The wage level is the most fundamental criterion of the progress of inflation. A rise of prices can be reversed without serious difficulty or dislocation, so long as it is not accompanied by a rise of wages. But, once wages rise, there is likely to be resistance to any reduction, and prices must be kept in due relation to wages, for otherwise the margin of profit will be insufficient, productive activity will fall off, and unemployment will appear.

Price control without wage control fails to guard adequately against the pressure of potential inflation. The fact that prices are lower than free markets would yield means that traders are deprived of their normal defence against an excessive demand, higher prices. They react to the pressure of demand by trying to extend output; they compete in the labour market for more workpeople, and wages are driven up. Controlled prices then have to rise in proportion to wages. And wages have in fact risen as much in Great Britain as in America. The increases of weekly rates of wages reported to the Ministry of Labour have been:

1946 . . .	£2,901,300
1947 . . .	£1,734,950
1948 . . .	£1,890,000
January-March 1949 .	£376,400
$3\frac{1}{4}$ years .	£6,902,650

The reports cover about 8,000,000 workpeople, so the average increase was about 18s. a week. That would represent approximately 20 per cent.

Hourly earnings averaged 24·3d. in January 1946 and 31.1d. in October 1948, showing an increase of 28 per cent.

Is it to be inferred that controls have done nothing to check inflation? Not quite, for the pressure was greater in Great Britain than in America. The financial strain of the war had been heavier, and the arrears of expenditure were greater.

But there was another factor tending to produce inflation in Great Britain. The pound has been linked to the dollar at a fixed rate of exchange of $4.03 ever since September 1939. As fast as inflation lowers the wealth-value of the dollar, the fixed rate of exchange brings down the wealth-value of the pound. In fact, after the controls were abandoned in the United States in June 1946 the contagion of American inflation was spread to Great Britain through the fixed rate of exchange.

The British controls might have withstood the pressure of redundant money, but against American inflation they were no defence. In June 1946, when the United States abandoned controls, the British wholesale price index (100 in 1938) was 171. In April 1947, when the budget was introduced, it was 184.5 and was continuing to rise.

In the year 1946-7 a deficit of £726 millions had been budgeted for, and the deficit on the actual out-turn was £569 millions. The year 1947-8 was the first that got substantially free from the entanglements of war finance. The Chancellor of the Exchequer, Mr. Dalton, estimated that the existing tax revenue would yield a surplus of £248 millions over the expenditure to be met. He had to decide whether this could be used for remissions of taxation. His decision was that the surplus must be preserved. That did not mean that the budget ought invariably to be balanced in each year, regardless of circumstances. 'Our purpose should be to balance the budget over a series of years. Each year we shall consider, in the light of the financial and economic situation, the movement of prices, the level of employment, the relative dangers of inflation or deflation, whether in that particular year there should be a budget surplus or a budget deficit. I submit that there can be no doubt that on this test this is a good year for a good surplus. There is a high level of employment. Prices are still rising—faster than we like. . . .

'We have sought to lubricate the economic system with a

sufficiency of purchasing power, much more evenly spread than before the war. That has been our aim, and we have achieved it. Therefore, deflation is no longer the immediate danger today. The immediate danger is of an inflation going beyond all bounds, and breaking through the various controls that we have set up.'

Accordingly Mr. Dalton more than offset decreases of taxation by increases, and budgeted for a surplus of £270 millions.

Seven months later (12th November 1947) Mr. Dalton presented a supplementary budget. 'We must strengthen still further, and without delay,' he said, 'our budgetary defences against inflation.' Measures that were being taken to increase exports and reduce imports would increase the inflationary pressure by reducing the supply of goods available in the home market. In fact, the opportunities to spend were to be further curtailed, and the pressure of redundant money on such opportunities as remained would be so much the greater.

The surplus originally estimated for 1947-8 was being more than realised, but Mr. Dalton thought it necessary to impose increased taxation to yield £208 millions in a full year (£48 millions in the remaining $4\frac{1}{2}$ months of 1947-8). When the time came for the budget statement of 1948, the surplus of 1947-8 had proved to be £636 millions. 'The size of the surplus,' the new Chancellor, Sir Stafford Cripps, said, 'is to some extent itself a measure of the inflationary situation.' The wholesale price index for April 1948 was 216.2, and had risen 17 per cent in twelve months.

Estimates on the basis of existing taxation indicated a surplus of £778 millions. There were to be substantial remissions of direct taxation of a kind to increase incentives to production. But the Chancellor held that he could not afford to give up any of the surplus. 'The expenditure of the government on capital account puts money into circulation and creates purchasing power, just as much as does the expenditure on revenue account, and has to be offset by private saving or by the revenue surplus.' From the estimated surplus of £778 millions there had to be deducted £190 millions of non-recurrent revenue, and £279 millions of capital expenditure,

leaving an 'overall' surplus of £319 millions. 'The question is,' he said, 'whether this is a sufficiently large sum for the purpose. In my view it is just about adequate, so that, if we are to do anything to increase incentives by adjustment of taxation, we shall also have to find fresh sources of taxation to set off against the remissions which we make. It is only in this way that we can provide what I regard as an exceptional surplus to deal with the inflationary situation.'

In order to balance the remissions of taxation a 'special contribution' was imposed. It was not a capital levy, in the sense of a tax assessed upon total capital, but was imposed on investment income, in order to reach 'those who possess large capital assets'. And it was to be a 'once for all levy', which the taxpayer might legitimately pay out of capital. It was to yield £105 millions, of which £50 millions would come into 1948-9. Here quite clearly was the intention of using the budget as an instrument of credit policy. Up to 1947 the wartime policy of combating the inflationary effect of deficits by means of price controls had held the field. The deficit of 1946-7 was still adding to the redundant money.

In the years 1938 to 1945 deposits in the clearing banks had risen from £2,277 millions to £4,692 millions and currency in circulation from £446 millions to £1,263 millions. In April 1947, deposits had risen to £5,583 millions and currency to £1,377 millions. Deposits were thus two and a half times and currency three times what they had been in 1938.

The national income had risen from £4,640 millions in 1938 to £8,111 millions in 1946. Deposits were 49.1 per cent of a year's national income in 1938, and currency 9.6 per cent. Had they been in the same proportion to income in 1946, they would have amounted respectively to £3,980 millions and £796 millions, that is to say, less by £1,603 millions and £581 millions than they actually were. To reckon the redundant money at £2,200 millions would actually be an underestimate. Something must be added for deposits in the banks (Scotch and other) outside the Clearing. Moreover, time deposits (which are included in the total) had increased much less than current accounts, the former from £1,033 millions to £1,956 millions the latter from £1,244 millions to £3,628 millions.

Time deposits had thus increased by only 89 per cent. But for anyone who wanted to put by money for a limited period, attractive alternatives to time deposits had come into being since 1938. The limits applied to savings bank deposits (which yielded $2\frac{1}{2}$ per cent, when time deposits yielded only $\frac{1}{2}$) enabled even wealthy people to accumulate quite considerable amounts—and the war had produced a wide range of medium-term securities. Even long-term securities became a serious rival to time deposits for temporary investment, when the government was apparently using its controls to force a gradually falling rate of interest (and therefore rising prices of securities) upon the market for long-term investments.

Moreover, the year 1938 was one of depression, with an average of 1,868,000 unemployed. The year 1946, being one of high activity with only 394,000 unemployed, would certainly under free conditions have had a lower proportion of cash holdings to income.

The amount of redundant money at the beginning of 1947 may well be put at £3,000 millions.

From April 1947, when the financial year 1947-8 began, the further expansion of redundant money through budget deficits was to cease. But to eradicate the potential inflation, it was not sufficient just to cease creating money: the redundant money must be reduced, and not merely reduced but altogether eliminated.

For that purpose the surpluses budgeted for were not the sole resource. Even in 1946-7 the country had begun to draw on the American and Canadian loans, and met from that source nearly £400 millions of the deficit of £569 millions. In 1947-8 sums of £655 millions and £66 millions were drawn from the American and Canadian loans, and, with the South African gold loan of £80 millions, made up a total of more than £800 millions.

Added to the surplus of £636 millions, that might have been expected to make a substantial impression on redundant money amounting to £3,000 millions. But the capital expenditure to be provided for amounted to £692 millions, and maturing debt required £300 millions.

In quiet times it would have been unnecessary to assume that surplus revenue must be provided to cover these capital items. The government would have issued loans, and the investment market would have provided the necessary funds out of current savings or, in other words, out of income. In the circumstances of 1947 and 1948 that could not be counted on. People who had money to spare needed in most cases to retain it for prospective outlays which had been too long delayed. And it was no doubt wise to treat the capital outlay of the government as a charge upon its own funds.

Perhaps the maturing debt, £300 millions of 3 per cent Conversion Loan, ought to be similarly treated. Government loans approaching near maturity come to be looked on not as investments but as money market securities. Some of the holders may regard them as permanent investments and may reinvest their money in securities of a more distant maturity. But a great part of the medium-term debt has been held all along as a temporary investment, a slightly more remunerative substitute for time deposits. The continuing repayment of maturing securities is an incident of their character as temporary investments. If they were redeemed by the creation of new floating debt, growing inflation would result. To prevent a further growth of redundant money, real resources must be provided for their redemption.

Thus from the surplus of £636 millions, and the sum of £800 millions raised on external indebtedness, must be subtracted the government capital outlay of £692 millions, and over £300 millions of maturities. A sum of about £400 millions was left for extinguishing redundant money.

But it was not so used. There was, it is true, a reduction of currency in circulation from £1,377 millions in April 1947 to £1,230 millions in April 1948. But the deposits in the clearing banks rose from £5,583 millions to £5,861 millions. The greater part of this increase is accounted for by a rise in advances to customers from £1,055 millions to £1,307 millions.

In fact, the policy of deflation through a budget surplus is incomplete unless it is accompanied by some method of preventing the money extinguished from being replaced by new

money created through bank advances to traders. The idea that budget surpluses are a sufficient substitute for dear money as the means of deflation is fallacious. A budget surplus applied to extinguishing bank credit is itself a measure of credit restriction, and its impact *may* be sufficient to set deflation in motion; but that is not necessarily so, and further measures of credit restriction may be necessary to prolong the effect of the impact.

We have had a policy of cheap money ever since 1932. Before the war its continuance meant no more than that we had not succeeded in emerging from a state of depression; the country needed a credit expansion, and the trouble was that cheap money failed to evoke it; dear money would have made matters worse.

Since the war, on the other hand, the urgent need has been to prevent a credit expansion. If we have dispensed with the time honoured method of contracting credit by the operation of high charges for bank advances, that is because we have been relying on controls to prevent inflation.

I have already pointed out that controls are an imperfect defence against inflation. I have also pointed out that the fixed rate of exchange between the dollar and the pound transmitted to Great Britain the inflation which was lowering the wealth-value of the dollar.

Had the price controls been accompanied by a control of wages, so rigid as to keep the wage level unchanged, an alteration of the rate of exchange favourable to the pound would have been almost unavoidable. For otherwise either the rising prices abroad would have yielded exorbitant profits to the British exporters, or alternatively export prices would have been disproportionately low in comparison with import prices. And, even without any wage control, if the dollar value of the pound had been progressively raised as the wealth-value of the dollar fell, the tendency to inflation from the American side would have been counteracted.

To prevent the potential inflation from becoming actual, that would have been necessary, but it would not have been sufficient. For the pressure of redundant money would still

have been swelling demand on all sides, and forcing up wages.

A budget surplus judiciously applied may be a powerful instrument of deflation. If it is applied to extinguishing bank credit and currency, then so much of the national income is prevented from generating demand. If spending falls short of production, the difference appears in the form of unsold stocks of goods, orders to producers for the replenishment of stocks fall off, and the slackening of activity characteristic of deflation supervenes.

But the fact that deflation is needed at all presupposes that there is an existing tendency towards excessive activity. Demand has been pressing on productive capacity, stocks have been reduced to a low level, producers are endeavouring to cope with accumulated arrears of orders There is a vicious circle, since demand induces production, production generates incomes, and incomes become the source of further demand. When a part of the consumers' spending power is intercepted by taxation and extinguished, the tension is relieved. But the vicious circle will not be broken unless the reduction of spending is more than equal to the current demand of the traders for goods to make good the shortage of stocks.

The question is one of the *magnitude* of the measures taken in comparison with what has to be done. If they are fully adequate, further support from the mechanism of credit restriction may be found unnecessary.

But in 1948 the resources made available were far short of what was required. The redundant money supplied people with the means of spending in excess of income, while the pressing arrears of necessary outlays ensured that this spending would be *used*, so far as productive capacity and controls allowed. Even had there been no growth of bank advances, the pressure of redundant money would have been little less. Bank advances were sought because the traders who were supplying the demand, and who needed additional working capital, were not individually identical with the holders of the redundant money.

For the year 1948-9 Sir Stafford Cripps announced an overall surplus of £352 millions, after meeting captial items.

Marshall Aid (amounting to £300 millions for the period to June 1949) was a substantial additional resource. Yet bank deposits in April 1949 were practically unchanged at £5,886 millions. Bank advances had increased by only £128 millions. The sterling national debt had been reduced by £495 millions. I doubt whether published materials are available to account for the whole difference, but I may mention that in the year 1948 sterling balances owned abroad were reduced by more than £200 millions.

Thus *nothing* has been accomplished by budget surpluses towards reducing the volume of redundant money. But the same volume of money is steadily becoming less and less redundant, because the progress of inflation is raising the price level, the wage level and the national income. In other words, our methods of preventing potential inflation from becoming actual have failed. Till a year ago the degradation of the pound was concealed by the fixed rate of exchange with the dollar. But since then inflation has been suspended in America and has been continuing here; the pound is being weakened relatively to the dollar. There is talk of devaluing the pound, though the time for that cannot be said to have come.

If the proportions of 1938 be applied to the national income of 1948, £9,675 millions, the deposits would work out at £4,747 millions, the currency at £930 millions. Actual deposits in April 1949 exceeded that standard by £1,139 millions, and currency by £329 millions. Comparison with the £1,603 millions and £581 millions of April 1947 reveals a substantial reduction; if the redundant money in April 1947 was £3,000 millions, it may be only £2,000 millions now. But that is not progress; it is *ground lost*. It is ground yielded to rising prices and wages, to inflation, to the degradation of money.

There is no prospect of budget surpluses being of a magnitude to make any adequate impression on the redundant money. Long before they can do so, inflation will have done its work.

What, then, is the solution? The special contribution of 1948, though in amount no more than a modest part of the surpluses of two years, implies a significant reorientation of

policy, in that it is intended to be paid *out of capital.* A surplus which is applied to extinguishing bank credit has a dual deflationary effect: it not only diminishes the quantity of money, but it withholds so much of the taxpayers' income from spending. But if the taxpayer meets the impost out of capital, the latter effect is lost.

The special contribution appears to imply a recognition that the principal need of the moment is a reduction of the quantity of money. But the amount yielded, £105 millions, is derisory in comparison with what is needed. An impost not only payable out of capital but assessed on capital might have yielded ten or twenty times as much, but, as Sir Stafford Cripps pointed out when proposing the special contribution in the House of Commons, staff could not be made available to make a valuation of all the capital assets in the country, and, even if it could, the assessment and collection would take years.

When a government has to raise money in excess of what the tax revenue can be made to yield, the normal recourse is to loans. But I have already pointed out that the redundant money is withheld from investment. It has remained in the form of loose money and has not been placed in interest-bearing securities because it is destined by the holders for necessary outlays as soon as the opportunities allow. There would be no prospect of raising a sum of anything approaching the magnitude required by an ordinary loan voluntarily subscribed. The only alternative to a drift into further degradation of money would seem to be a forced loan. A forced loan, as in the Belgian monetary reform of 1944, can be assessed *directly* on the loose money. A suitable proportion of bank deposits can be transformed at a stroke into interest-bearing holdings in a long-term or medium-term government loan. The assessment on bank deposits, though arbitrary, is not unfair, because everyone receives a full equivalent of what he gives up. What he has to surrender is *liquidity,* and arrangements would, no doubt, have to be made to provide cash for those holders of the loan who really needed it. The demands for cash would have to be kept within limits by the recognised devices of credit regulation, including, if need be, a high bank rate.

I will not follow this proposal out in detail, for it is not

likely to be adopted. I mention it because it appears to be the only method by which the progressive inflation from which we are suffering could be effectively stopped. Would not dear money be an effective remedy, without any forced loan? It would be worth trying. But those intending spenders who have loose money in hand and do not need to borrow would be unaffected by it. And it would encounter almost as much opposition as the forced loan itself, partly on the ground that it would add scores of millions, possibly hundreds of millions, to the budget charge in respect of the floating debt, partly on the ground that dear money would *do its work*. Dear money, in fact, has to be used very cautiously, and with a delicate touch. The former skill in applying it has long been forgotten, and experience of the bludgeon blows of 1920-2, 1925-7, 1929 and 1931-2 has led people to regard it merely as an instrument for causing depression and unemployment on a disastrous scale.

Issuing Houses and the Raising of Long-Term Capital in London

By

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It is a great pleasure for me to have this opportunity to talk about Issuing Houses, for the City of London is too much of a mystery, and more particularly is this the case with the business of raising capital in all its different forms. I would, therefore, like to trace the history and origin of issuing houses, to tell you how they came into being and to say something about their activities, methods, and the preparatory work and effort which go into the making of a public issue of securities.

Issuing houses have a proud history, and it is no exaggeration to say that the older ones contributed in large measure towards the development of the British Empire: at the same time they were the cradle of the Americas. It can be truly claimed that it was the capital provided by the City of London which opened up the prairie lands of North America and the pampas of South America and which linked them to their ports by railways; which fertilised the barren lands of the Empire and Egypt, and which constructed a network of communications in India and the Far East.

A glance at a list of old prospectuses of issues made in the City of London readily bears this out. A review of these prospectuses reveals to what extent as a result of these activities this small island, without any special natural mineral advantages, except coal, succeeded in balancing its own trade, rose to a paramount position in the world, and became the pivot of the British Empire.

Recently, of course, as part of the price it has had to pay for waging and winning two world wars, it has had to yield—though we believe only temporarily—its pre-eminent position in the financial world.

Such indeed were the achievements of the old investment bankers and issuing houses that, even twenty years after the first of these catastrophes (in 1938) it was estimated that British long-term investments abroad—not counting liquid balances and gold—still amounted to some £4,500 millions; of course, translated into terms of today's money values, this total would be at least twice or three times greater than that amount.

It may interest you to know that approximately £2,300 millions was invested in British Empire countries, some £1,500 millions in the United States of America and South America, and the balance was scattered over Europe and Asia. The income derived from these overseas investments amounted to nearly £200 millions a year and covered the cost of about 25 per cent of our imports in 1938.

As with so many other British institutions, the machinery for raising capital was not consciously created. It grew gradually as a natural process, the reason being that Britain was a great commercial nation long before the industrial revolution, and long before she became a great financial nation and the banker of the world.

In the eighteenth century the City of London was the centre for world trade and commerce. The great continental merchant banking houses, some of which are still going strong today, established themselves in the City. These private banks were first and foremost active in promoting commerce; later, however, they made themselves responsible for the raising and issuing of foreign loans, and thereby they became the first investment bankers or issuing houses. It was not, however, until this century, and really only since the end of the first world war, that the well-known issuing houses in the City began to underwrite the raising of capital for home industrial purposes, as distinct from foreign loans.

The raising of long-term capital in the City for the needs of industry in this country is thus a comparatively recent development. Why should this have been so? The reason is largely

historical. The first industrial units were small and it was possible to finance them on a family basis. As they grew larger, and additional resources were required, these were obtained from relatives and friends, profits being ploughed back all the while. It will be understood how comparatively simple it was to do this in those days, when it is realised that as recently as the beginning of this century the highest income group paid only 5 per cent or so in taxation, whereas today the highest graded taxpayers in Britain, by contrast, pay 90 per cent or more of their gross income.

With low taxation and good profits, a section of the population was always seeking opportunities for employing its money to greater advantage, and at times at considerable risk. Capital could be raised locally, and largely through the personal knowledge and standing of the firm concerned; there was no need for the employment of an intermediary organisation such as an issuing house.

The approach to the raising of long-term capital in England during the nineteenth century was very different from that on the Continent. Germany, for instance, deliberately set out to create an industrial state. The impetus for expansion came from above rather than from below, and the demand for capital could only be met by the banks, there being at that time no public savings of any consequence available for investment. This led to the development of the great German credit banks and to a much closer connection there between the banks and industry.

In France a not quite comparable but somewhat similar evolution took place. There the banques d'affaires emerged as an instrument to finance industry, and there it was not a lack of private savings for investment as in Germany, but rather a century-old habit of investing in French and foreign government bonds and other fixed-interest bearing securities, which kept the public aloof from industrial securities with their attendant risks.

In this way a close connection grew up on the Continent between the banks and industry, the reverse of what was happening in England, where the banks confined themselves to short-term finance and took no deliberate or controlling interest in

industry, which continued to be financed in the main by the private individual.

Towards the end of the nineteenth century industry was not only rapidly expanding, but also became more international both in scope and character. Capital issues were becoming more frequent, and on a scale not dreamt of fifty years earlier. In addition, foreign governments and municipalities were looking to London not only for short-term commercial loans, but also for long-term finance.

In the home market it was becoming more difficult to find private finance of a sufficient volume to meet the increasing requirements of industry, and as a result issuing houses came into their own. They gradually became the recognised arbiter, assessing the justification of a demand for capital, and, when satisfied, subsequently presented that demand to the public by means of an issue, pledging their name in support of it.

It took some time, however, for the Courts to look with favour on the payment by companies of a commission for having a new issue guaranteed or underwritten by an issuing house. Underwriting was only given legal status for the first time by the Companies Act of 1900, the Courts up to then having taken the view that it was wholly wrong to allow a company to pay an underwriting commission for the issue of its own shares, this being regarded as little better than the payment of a bribe. In fact, the practice of underwriting only obtained full recognition in the Companies Act of 1908.

It was only thereafter that the rise of issuing houses commenced on a larger scale, but the first world war intervened before the underwriting of home industrial issues became common practice. In the meantime trade and industry were expanding apace, and the period after the war of 1914-18 saw a great increase in the demand for long-term loans and permanent capital to finance all the reconstruction and new development work which had to be undertaken.

But the capital market for home industry was not really effectively organised in the City at that time, and it is doubtful if there were sufficient issuing houses of standing to deal with the demands for industrial capital. England had led the world up till then in other similar fields of financial activity, and it

was only natural that she should attempt to do likewise in the raising of capital. Unfortunately, attracted by the opportunities offered, a large number of finance companies with inadequate resources, and very few connections, appeared on the scene: they were only too eager to profit whilst the public were in an investing mood and generally to make hay while the sun was shining. They were responsible for the marketing of many issues covering projects only too scantily investigated, and many investors were bamboozled during that period of speculative fever. The public's loss was indeed very great, and many of the securities concerned had, all too soon, no ascertainable value.

The troubles of this period were thus a sorry commentary on the first postwar effort, and were largely responsible for the aspersions which were cast on all and sundry engaged in this type of business. The failure of some issuing houses, mostly newcomers, to rise to the occasion, and the subsequent default of many of them when their issues found no response, were partly the cause for the setting up by the government of the day of an important committee on finance and industry. This committee, generally known as the *Macmillan* Committee, made its report in 1931.

In this report the interesting and significant statement appeared that 'it would be an important reform that relations between finance and industry should be so developed that Issuing Institutions of first-class strength and repute should vouch to the investor more normally and more fully for the intrinsic soundness of the issues made. . . . In this way the investor would be encouraged to support well-vouched issues and be put on guard against others'.

The truth is that in the period under review a new investing public had made its appearance—a public which was by no means well informed and which was far too inclined to venture its money in speculative projects, which ultimately, as mentioned before, proved spurious in many cases. At the same time, the collapse of international exchange made the raising of international loans in London impossible, and it followed almost as a matter of course that the great acceptance houses, merchant bankers and investment bankers turned more of their

attention to the underwriting and raising of home industrial issues. Thus the decade prior to the outbreak of the second world war saw another big upswing in the volume of this type of business launched under their auspices.

During the war industrial issues were few and far between and were only permitted in cases of paramount importance in connection with the war effort.

Since the war there has been a great amount of new issue business, not only as a result of the pent-up demand for new capital following the dead period between 1939 and 1945, but in order to provide industry here with the necessary funds to meet the vast calls on it, and to re-equip itself with up-to-date machinery and plant. In addition, a large number of private owners of companies have been forced, mainly owing to the necessity to prepare for the existing crushing death duties, to dispose of part of their interests to the public by means of either public issues or private placings on The Stock Exchange.

Issuing houses have thus experienced a period of useful work, and many varieties of issues have been offered to the public these last few years. Although there has been great activity, there has been nothing to compare with the feverishness of the post 1914-18 war period, and there is no doubt that the new issue market has on the whole given a much better account of itself, especially with regard to quality. The standard of investigation and the general approach to the problems involved have improved considerably, and as will be seen later, the public are now afforded a much greater measure of protection than ever before.

A goodly proportion of the new issues will stand the test of time, but of course there has already been some wreckage, and probably more is to be anticipated. In retrospect, too, it is certain that some of the issues were brought out at too high a level, advantage being taken, quite legitimately, of the period of artificially cheap money which has prevailed since the war, and which indeed has only recently shown signs of changing.

Since 1945 some new names have been added to the list of issuing houses, whilst others have been rejuvenated, and it can be stated that in the majority of cases they have worthily upheld the best traditions of the new issue world.

In 1945 an Issuing Houses Association was formed, and soon became fully representative, now comprising some fifty-six members. Its main objects are to enable issuing houses to speak with one voice on all matters of principle affecting the issuing business, and to protect and advance their interests as a body. The Association does not seek to fetter, prescribe or regulate the manner in which its members carry on their respective businesses, but the rules give it power to refuse membership to any firm or company of which it does not approve, and it is thus obvious that undesirable applicants would be precluded from membership. This formation of their own Association was a mighty step in the history of issuing houses as a whole. It has given them a greater sense of unity and common support, although it must be emphasised that this does not mean that competition is any less acute, for the contrary is the case.

Investors now have many safeguards, which were not in existence when they suffered such heavy losses in the slump which followed the 1928-9 boom period. Since then there have been two major revisions of the Companies Acts—those of 1929 and 1948—and in addition the rules of The Stock Exchange have been revised and greatly increased in their severity. In the last resort The Stock Exchange have the power to refuse the request of a company which wishes to have its shares quoted, if the information provided is not considered satisfactory from their angle—a powerful weapon with which to protect the investing public from subscribing to undesirable undertakings.

Furthermore, there are in existence today two other unofficial bodies, which, although primarily directing their activities towards the protection of holders of existing securities and to investigating any modification of the *status quo* propounded by schemes of arrangement or for repayment of capital, do nevertheless play an important part in obtaining fair play for investors in general. I refer to the Association of Investment Trusts and the Investment Protection Committee of the British Insurance Association.

Further controls on the raising of capital were established by H.M. Treasury with the setting up on the outbreak of war of

the Capital Issues Committee, to which Committee all new issues of capital, exceeding £50,000 in any one year for a particular company, must be submitted for approval. Likewise any re-arrangement of the existing capitalisation and writing up of assets involving a new issue, or declaration of a bonus issue, have to be approved by the Committee. The duty of this Committee is not to judge the actual quality of an issue—indeed, it takes no responsibility whatsoever in that respect—but rather to control the flow and direction of capital and to ensure that no issues take place which are contrary to the national interests at this time of stress and strain in the British economy. Through the Bank of England, the Capital Issues Committee also regulates the actual timing of any issue for which it has granted permission. Accordingly, you will see that today the raising of capital is subjected in one way or another to very complete and vigorous control and supervision.

It is, of course, inevitable that these controls should cause delays, which add considerably to the difficulties of all concerned. Unless the issue is of a stereotyped nature, such as a conversion operation, the application to the Capital Issues Committee, which is required in very detailed form, is passed before consideration by them to any government department which might be interested in the proposition. These may number as many as six departments, and an issuing house has often to anticipate a wait of as much as four weeks and sometimes longer before the verdict of the Capital Issues Committee is received. With conditions changing as rapidly as at present, it is easy to appreciate that the plans originally formulated can become impossible of execution by the time the answer is forthcoming. Some assistance is now afforded, inasmuch as the Committee allows the applicant to ask for a modest latitude either way in the price of the issue, thus obviating the necessity of a further application should the price originally proposed become out of line in the interval. Nevertheless, one can only most sincerely hope that the imposition of the Capital Issues Committee on the free work of issuing houses will be abolished as quickly as circumstances permit.

It is unusual for issuing houses to lock up their own funds in

investments of a permanent nature—they must keep liquid to meet untoward eventualities—and must therefore rely for subscriptions to their issues practically entirely on money from outside sources: in other words, the general public, the pooled resources of the man in the street, together with the accumulated funds and reserves of financial institutions such as insurance and investment trust companies. This body of potential investors, who will also to a large extent comprise the sub-underwriters of an issue, must all be fully informed and satisfied in regard to the propositions put before them: hence it behoves the issuing house, before it makes itself responsible for an issue, to examine the proposals with the utmost care, looking not so much to the short-term outlook, i.e., whether it can achieve an immediate success by obtaining an over-subscription, although very satisfactory notwithstanding, but to what is vastly more important, whether the investment concerned, if it is an ordinary share, has more than a reasonable possibility of yielding the holder a steady and increasing return on his money over the course of years. In the case of a fixed-interest bearing security, there must be ample earnings available for the dividend or interest requirements, plus adequate assets to cover the amount raised should the company fall on bad days and a liquidation be necessary.

Let us now examine the sequence of events from the moment when an issue is first mooted. The issuing house will require a clear statement of all the relevant figures—the past record of the company in question, and if it is an established one, an assessment of its future prospects. Careful and independent enquiries are made as to the general standing of the prospective borrower, particular attention being paid to the character, capability and continuity of its management. Assuming that satisfaction is obtained on all these points, the issuing house will then make recommendations as to the best method by which the new capital should be raised and, alternatively if necessary, plan a rearrangement of the existing capital structure.

The issue may be of debentures, of notes, of preference, ordinary or deferred share capital, and great skill and judgment are required in deciding upon the price of issue. The

determination of the price is half the art of an issuing house, and repeated faulty judgment in that respect will reflect on its reputation. If an issue goes to a substantial premium, i.e., the price is fixed too low, the borrower may well be disgruntled. If as a result of fixing the price too high, the issue is a failure, and falls to be taken up by its sub-underwriters, the borrower has equal reason to be displeased, because the resultant discount on the newly issued security cannot be other than unsatisfactory to him and may even affect his credit or standing.

Considering the great responsibilities they assume, and the vast amount of work involved in an issue, issuing houses are normally very modest in their charges, and one might stress that contrary to the general trend, these are lower now than before the war. Issuing houses are usually remunerated for their services by payment of an overall fee, which covers their own reward, the fee to the stockbroker for his work in connection with The Stock Exchange requirements and for his general co-operation, the sub-underwriting commission, brokerage on allotments, advertising charges, and their own legal and accountancy costs. Full details must now be clearly enumerated in the published prospectus, or other statement, for all to see exactly what is paid to those concerned in the issue.

Most issues of any importance take the form of a public offer for subscription on the terms of a prospectus, which should set out clearly and concisely the relevant information and reports by accountants and other experts regarding the business, which have been collated by the issuing house.

The Companies Act, 1948, provides in effect that two clear days shall elapse between the publication of a prospectus and the opening and closing of the subscription lists. There is therefore full opportunity for the investor to scrutinise prospectuses, and for criticism and comment to be passed on them by the financial Press.

As we have just seen, a public issue entails many expenses. Much of the cost is of a fixed and irreducible nature, and is therefore relatively heavy if a small amount is being raised. For this reason, it is usual and more economical to resort to

what is known as 'a placing' if the amount involved is less than, say, £500,000, and if a quotation is desired.

In essence 'a placing' is the issue of securities to a limited number of persons of substance, or to companies and institutional investors, who are well known to the issuing house. Where a quotation is sought, a certain proportion of the securities concerned has to be made available for dealings on The Stock Exchange.

Sometimes securities are placed privately, and a quotation is dispensed with. In those cases the question of advertising costs does not of course arise, and it follows that the other charges are also less.

Although the majority of issues today appear under the auspices of an issuing house, it happens sometimes that stockbrokers who are members of The Stock Exchange undertake the responsibility for new issues. This tendency is usually more noticeable when general conditions are flourishing and the raising of new capital presents few difficulties. However, recent experience teaches that companies needing new finance are coming to realise that issuing houses, whose speciality that business is, offer the best service, possessing as they mostly do well-equipped organisations for both pre-natal and after-care attention.

In general, issuing houses work in close harmony and friendship with The Stock Exchange, and one should not underrate the important part stockbrokers play in the preparation and launching of new issues, albeit mainly in an advisory capacity to issuing houses. It is essential that this close co-operation between the two main bodies dealing with investments should continue, but yet it would seem that the making of issues is for the reasons stated more the function of an issuing house than of a stockbroker. However, the borrowers and the public must be the best judges of this question, on which a measure of controversy exists, but it strikes one that a duality of function arises when new issues are sponsored by stockbrokers.

Having talked about the opening and closing of lists, it is now time for me to close this lecture, being fully aware that I have merely touched the fringe of a complex subject. It only remains for me to stress the vital importance of

the continuation of the existing efficient arrangements in the City of London for marrying the supply of new savings with the demand for new money on the part of a multiture of borrowers. The issuing houses perform that important role by bringing about these marriages of convenience. As long as they continue to pursue their clearly defined task, maintaining the high standards they have set themselves, there is no doubt that they will remain an all-important link in the development of our economy, and that they can add to their great past a still greater future.

At the moment we are going through a phase when too little courage and enterprise are being shown, and too many are looking merely for security. It is to be hoped that that phase will soon pass, for no nation can remain great unless it numbers amongst its citizens those who are prepared to be courageous, enterprising, and far-sighted. It was that spirit which created the British Empire and prompted private capital to support ventures of a constructive and developing nature, both here and in foreign parts. Has all that passed for ever? We are poor, we are hemmed in by restrictions of all sorts, and our present heavy burden of taxation certainly does not encourage initiative and incentive, but as an optimist and knowing the British spirit, I refuse to believe that it has.